# Law and economics—a reply to Sir Anthony Mason CJ Aust.†

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## *Introduction*

In the 1992 Monash Law School Foundation Lecture,[1] delivered by Sir Anthony Mason, in March of this year, the Chief Justice of Australia expressed grave reservations concerning the extent to which economic analysis can or ought to be employed in the courtroom. Although prepared to recognize a limited role for economic theory in the law and policy formation process, the Chief Justice was generally critical of the widespread use of economic analysis in the handling of issues before a court. Without doubt many of the points made by the Chief Justice are valid: it is not necessary to apply economic analysis in areas where traditional methods of legal scholarship - such as black letter law doctrinal analysis - provide superior results. For instance, only black letter law can be used to determine whether a particular option (whatever its economic or other policy merit) is open to a court, since in making their decisions, courts are constrained by the tight confines of law, rather than by the broad horizons of economic policy. Nevertheless, in this paper, I shall attempt to show that the Chief Justice is overly cautious in his approach to economic analysis: there are many questions (particularly those relating to the initial identification of options and the implications of decisions) which can be better answered by economic analysis than by traditional methods of legal scholarship. For this reason, the generally critical views expressed by Chief Justice Mason are at least overstated if not unsound.

The general thesis of this paper is that there are important issues in cases which come before courts that can be brought into sharper focus through a systematic application of economic analysis in the broader

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† Based upon a lecture delivered at the School of Law, Deakin University, October 16, 1992.

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1 Reprinted as 'Law & Economics' (1992) 17 *Monash Univ. L. Rev.* 167.

analysis of legal problems, and that therefore the courts should be more willing to employ economic analysis overtly in dealing with many types of disputes which come before them. More particularly, economic analysis often simplifies the identification of the distinguishing features of a case which separate it from other cases. Such differentiation permits the courts to make more informed decisions as to which of two or more competing rules should be applied to the case, and, in a novel case, to decide whether some new rule should be crafted to deal with the unique facts identified in that case. Second, economic considerations such as cost and benefit have a clear policy implication, which even if they are not determinative of policy questions that courts are called upon to answer, are most surely relevant to those decisions. Third, once a policy decision is made concerning a particular entitlement, economic analysis will allow the courts to identify clearly, and focus their decisions upon, the specific problems with which they are concerned, so as to facilitate the application of the rules that they set down to cases that arise in the future.

In other words, a clear and compelling answer can be given to the essential question underlying the Chief Justice's lecture (namely, what does economic analysis teach us that the methods of traditional legal scholarship does not): economic analysis can be effective in analyzing the issues presented by legal disputes, clarifying the nature of the choices that have to be made, identifying the choices that are open, and predicting the probable consequences flowing from the selection of each of those choices. So employed, economic analysis does not dictate policy choices (which appears to have been the Chief Justice's primary concern), but rather allows the courts to advance more effectively the policy goals inherent in their decisions.[2]

At the bottom line, the economic analysis of law constitutes an attempt to adopt and apply a more systematic approach to the study of legal questions based upon a scientific method. Through a complementary process of empirical observation and model construction and refinement, the factual assumptions upon which rules of law are based may be tested. The goal is to undertake a methodical verification of the truth or falsity of the many assumptions upon which legal rules are based, through the study of empirical evidence, the development of

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2 See, generally, White, B., 'Coase and the Courts: Economics for the Common Man' (1987) 72 *Iowa L. Rev.* 577.

predictive models based upon the study so concluded and consistent assumptions concerning human behavior, and the testing of the accuracy of those models by further empirical examination.

Too often legal policy makers (principally judges and legislatures) justify the rules that they adopt solely in terms of their underlying objective. The real value of a particular rule to society is not what the policy maker wished the rule to achieve, but rather what it actually achieves or what it can be expected to achieve, given our understanding of human affairs in general. The standard of measurement is one of empirical consequence not intent. One hope which the economic analysis of law offers is the ability to measure more accurately the real world effect of legal rules.

### *The economic analysis of law*

Since few Australian lawyers have much exposure to the subject, it is perhaps worthwhile to provide some general information concerning the economic analysis of law. The term 'economic analysis of law' has come to describe a particular school of legal theory which has evolved over the past thirty years, in which micro-economic theory is systematically applied in the analysis of a wide range of legal problems and issues. While there is general agreement among most lawyers and policy makers that economic analysis has a role to play in areas such as antitrust, contract law, commercial law, corporate and securities law, and so forth, there are some who would argue that study of economics can provide useful insights into many areas of law that are not so closely tied to economic activity. Thus there have been articles arguing that economic analysis should be applied to areas such as family law[3] and criminal law.[4] The most extreme view, put forward primarily by economists and lawyer-economists of the Chicago school, is that the in-

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3 See, for instance, Trebilcock, M.J. & Keshvani, Rosemin, 'The Role of Private Ordering in Family Law: A Law and Economics Perspective' (1991) 41 *U. of T. L.J.* 533.

4 See, for instance, Becker, G.S., 'Crime and Punishment: An Economic Approach' (1968) 76 *J. Pol. Econ.* 169; Posner, R.A., 'An Economic Theory of the Criminal Law' (1985) 85 *Col. L. Rev.* 1193; Wolpin, 'An Economic Analysis of Crime and Punishment in England and Wales, 1894-1967' (1978) 86 *J. Pol. Econ.* 815; Witte, 'Estimating the Economic Model of Crime with Individual Data' (1980) 94 *Q. J. Econ.* 57.

herent logic of the law in all or nearly all areas is that of economics. For instance, so extremely has Richard Posner on occasion put forward that the entire legal system should be redirected toward the maximization of aggregate community wealth through the systematic introduction of efficiency enhancing rules of law:

> ...the goal of such action is to bring about the allocation of resources that makes the economic pie as large as possible, irrespective of the relative size of the slices. It means in other words using cost benefit analysis as the criterion of social choice, where the costs and benefits are measured by the prices that the economic market places on them or would place on them, if the market could be made to work.

The growth in the use of economics as a tool for the analysis of law has been one of the strongest currents in North American legal scholarship over the past thirty years. The trend is evidenced by the number of law journal articles,[5] journals of economics[6] and legal texts adopting the analytical methodology of economics in the discussion of legal issues, and also by the appointment of a number of economists on a full or part time basis to the faculties of some of the continent's most prestigious law schools. While the growth of the 'law and economics' school of analysis originated and has been most evident in the United States, it has not been confined to that country. During the early 1970s, increasing attention to economics became evident in English legal scholarship,[7] and a similar trend emerged in Canada towards the end of that decade.[8]

Whether or not economic analysis has had the most extensive influence of all the social sciences in the growth of legal theory over the last few decades is debatable; there can be little debate, however, that its

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5 See, for instance, Demsetz, H., 'Toward a Theory of Property Rights (1969) 57 *Am. Econ. Rev.* 347.

6 Including a number of journals exclusively devoted to the field, principally, the Journal of Legal Studies, the Journal of Law and Economics and the International Review of Law and Economics.

7 See, for example, a collection of papers edited by Burrows, P. and Veljanovski, C., 1981, *The Economic Approach to Law,* Butterworths, London.

8 Trebilcock, M.J., 'The Prospects of "Law and Economics": A Canadian Perspective' (1983) 33 *J. Legal Ed.* 288.

impact has been the most profound. As Michael Trebilcock (the Dean of Canadian law and economics scholars) notes:[9]

> Because economics offers so rigorous, coherent and persuasive a set of analytical paradigms (in its own terms), it has challenged other legal theorists in ways that have rarely been challenged before to develop and articulate competing paradigms of similar rigour and coherence. The recent revival of interest in legal philosophy, legal history and critical legal studies can, to a significant extent, be viewed as a response to the challenges of law and economics. The role of law and economics as an intellectual *agent provocateur* should not be underestimated and should be seen as a strength to be nurtured.

The conclusion that the economic analysis of law has served as an *agent provocateur* falls quite a good distance short of proving (as the most strident advocates of economic analysis suggest) that the maximization of economic efficiency is the governing rationale in legal decision making. A more guarded evaluation of the role of economic analysis in the study of law is put forward by Ernest Gellhorn, who states (in the context of the use of economics in antitrust law) that:[10]

> In the rush to accept or deny the application of economic analysis to antitrust questions, there is a tendency to overlook its role and function. The result is that true believers of the law-and-economics school may appear to over-predict its importance, while the anti-economics neopopulists seemingly reject obvious truths. A closer look at the practical uses of economics in antitrust cases suggests that the real value of economics lies somewhere in between these two extremes. Often, its utility depends on the questions being asked and answered.

Such empirical evidence as is available tends to support Gellhorn's minimalist assessment, rather than the more optimistic pronouncements of Posner and his disciples as to the extent to which economic theory can

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9 'The Prospects of "Law and Economics": A Canadian Perspective' (1983) 33 *J. Leg. Ed.* 288 at 290.

10 'The Practical Uses of Economic Analysis: Hope vs. Reality' (1987) 56 *Antitrust L.J.* 933.

be transplanted to the legal setting. For instance, in a recent review of economic analysis in American tort law cases,[11] it was noted:

> [Among] the presumably thousands of tort cases published during the nearly three decades covered by this analysis, only a small fraction made explicit use of the economic approach. Moreover, even in those opinions where Calabresi's or Posner's writings are mentioned, the reference is often made perfunctorily without real significance in terms of judicial process.... There can be no doubt that the modern economic approach to law has left its mark on judicial reasoning in a considerable number of tort opinions. However the reformatory effect of "explicit" economic analysis has been limited, if not completely absent.

In his lecture, Chief Justice Mason clearly took issue with the Posnerian view of the world[12] that the 'logic of the law' is economics.[13] Posner's suggestion that legal rules can be guided and applied entirely or even primarily by reference to economic considerations could not be implemented without a radical re-thinking of basic common law principles, including the rule of law as it has been traditionally understood. Given the extremity of Posner's argument, it is difficult to take issue with the Chief Justice's main conclusion that 'the larger claims of the law/economics school cannot be supported.'[14]

However, Chief Justice Mason's secondary conclusion (that economics has only a very limited role to play in guiding judicial rule making) is more controversial. This article will show that contrary to the assumption of the Chief Justice there is a well-established tendency in the courts of common law of using economic rationale and analysis in justification of judicial decision making. More importantly, it will show (by reference to the High Court's decision in *Waltons Stores (Interstate) Ltd v. Maher*[15]) that the courts may employ economic analysis to sharpen the focus of their decisions and to formulate more pre-

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11 Englard, I., 'Law and Economics in American Tort Cases: A Critical Assessment of the Theory's Impact on Courts' (1991) 41 *U. of T. L.J.* 359 at 369.

12 Which is most comprehensively, if not most clearly set forth in his text, *The Economic Analysis of Law*, 1986, 3rd edn, Little, Brown & Co., Boston.

13 Ibid, at 23.

14 See 'Law & Economics' (1992) 17 *Monash Univ. L. Rev.* 167, at 180.

15 (1988) 164 CLR 387 (H.C. Aust.).

cise rules of law that can be applied in a more systematic and predictable manner in subsequent decisions.

The Chief Justice's thesis (which is not clearly articulated) would appear to be that while economic analysis may make a valuable contribution in the legislative process,[16] it has no role (or, at best a very limited role) to play in the judicial arena. His main concern seems to be that if judges employ economic analysis in their decision making they will necessarily stray away from the application of law towards the *ad hoc* application of a 'predetermined ideology'. He stated:[17]

> The courts have no charter to articulate legal principle in order to serve particular economic goals. Nor are curial procedures adapted to achieving those goals.... The dilemma we face is this: if we seek to make judges more aware of the implications of economic analysis and of the potential use of economic information, how can they then conceive of it in any but an instrumental or normative way? If counsel present an argument based on economic analysis which suggests that judgment for the defendant would lead to wealth maximization for society, how does a court take account of this if previous authorities or considerations of justice or morality point in the other direction? As I have said, there is the possibility that courts would set at risk their own standing were they to decide such cases on the basis of the economic approach. That said, what benefit is to be derived from the presentation of the economic arguments if the court decides in the contrary manner. I must confess to serious misgivings about the prospect of courts proceeding to make or adopt economic analyses, including cost/benefit analyses, for the purpose of *determining* whether it is proper to impose liability on a defendant, that is, hinging the decision on a judgment that the community or a section of the community can or cannot afford that liability.

While these observations (although conservative) are not particularly startling, there are other passages of the Chief Justice's lecture which display an indifference or hostility to economic analysis and concerns that is truly disturbing. A particularly disturbing current running through in the Chief Justice' s lecture is the implicit assumption that the law can and should advance with scant attention being paid to economic consequences. For instance, with respect to the law relating to recovery of pure financial loss, he writes:

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16 See 'Law & Economics' (1992) 17 Monash Univ. L. Rev. 167 at 169.

17 Id at 180-181.

> The significant feature of the discussion in all the recent cases in Australia and the United Kingdom concerning the recovery of pure financial loss is the absence of any examination of the general economic consequences of the recovery of such loss.... In Australia, for the most part it appears to have been tacitly assumed that economic consequences are irrelevant to the formulation of the principles governing the recovery of damages, including economic loss for negligent acts and omissions.

There can be no debate that the role of economic policy in the courtroom is limited, and so it should be. The role of the judge is to apply the law, not to engage in arm-chair economic theorizing. If the logic of the law was economics, we would hire economists and not lawyers to be our judges and legal advisors. To conclude that economic policy can play only a limited role in judicial decision making, however, is not to conclude that there is a limited role for economic analysis. Yet this view is repeatedly put forward.

Consider, for instance, the following passage of his lecture:

> ... the underlying notions of the law/economics school—maximizing wealth, efficient allocation of resources or achieving a high level of public welfare—are ideologies in the relevant sense. What is more, if these notions were to become the decisive or dominant legal criteria, *Donoghue v. Stevenson* and *Waltons Stores (Interstate) Ltd v. Maher* might well cease to be part of our law. Economic rationalism is by no means synonymous with our ideas of justice.

The premise of this criticism (that justice and economic efficiency are inimical) is unsound. For example, the decision in *Donoghue v. Stevenson,*[18] which proclaimed that manufacturers were liable to ultimate consumers for negligently manufactured products, can readily be supported in economic terms, particularly when the offered alternative is no liability at all. But does it necessary follow that the law should stay wedded to a negligence basis of liability in the product liability area? In recent years, there has been considerable debate as to whether a negligence standard is appropriate in particular settings, or whether a

18 [1932] AC 562; All ER Rep 1 House of Lords.

strict liability regime should be adopted.[19] In order to understand the merit of each of these options, it is necessary to have an understanding of their economic consequences. As I will discuss momentarily in the context of the *Waltons' Stores*[20] decision, pursuing a traditional black letter law analysis in the hope of resolving this difficult policy question is more likely to produce confusion than a clear rule of law.

### *Similarity of subject matter*

One may concede that the starting point for any judge or lawyer in the analysis of a legal problem is to conduct a comprehensive review of the law applicable to that problem. In a democracy we must be governed the rule of law, not the rule of economic or other social policy. Where the law is clear, that law must be applied by the courts, irrespective of its economic or other social consequences. In cases where the law is less clear, however, economic analysis can often play an important role in defining the problem that must be resolved, and bringing issues (such as the practical consequences of alternative policy choices faced by the decision maker) into sharper focus. Furthermore, in all cases we should be concerned with the actual day to day effect of the rules that the law embodies: particular concern is always required where there is reason to believe that the law may be failing to accomplish the goal for which it was intended.

One reason why economic analysis can play this useful supplemental role in the study of legal problems is that economics provides a range of analytical tools ideally suited to many of the problems which confront legal decision makers. On an intuitive level, economic theory does seem to enjoy a close relationship with the law. In part, the connection between law and economics derives from the fact that economic relationships are governed and must be structured within the framework of the law. So too, since the production and allocation of wealth is so integral an aspect of every major society, it is at the very least ill-advised not to take the economic consequences of a particular law or proposed law into account. Economics is the study of man's behavior in

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19 See, for instance, (in the product liability context) Landes, W. & Posner, R.A., 'A Postive Economic Analysis of Products Liability' (1985) 14 *J. Leg. Stud.* 529; c.f. Priest, G.L., 'A Critical History of the Intellectual Foundations of Modern Tort Law' (1985) 14 *J. Leg. Stud.* 461.

20 (1988) 164 CLR 387 (H.C. Aust.).

producing, exchanging and consuming the products and services that he wants. The law is largely the study of the social rules governing such production, exchange, and consumption.

However, on a more fundamental level, law and economics are connected not so much because one is bound to affect the other, as because both have a similar preoccupation: they both are concerned with the allocation of scarce resources. If there was enough of everything to satisfy everyone's desires (or, possibly, even everyone's needs) then there would be no need of either law or economics. No one would steal if there was no reason to covet; nor would exchanges take place if everyone had immediate access to as much of everything as they needed. Unfortunately because resources are scarce, neither of these situations is likely to arise, and therefore it is necessary for us to decide who gets how much of the little that we have. Because they are concerned with similar basic issues, law and economics may be seen as a natural complement to each other.

On an even deeper level, a further connection between law and economics is that both are concerned with rational decision making. Akin to the question of scarcity is that of choice. Choice is the process by which decisions are made. Choice and scarcity go hand in hand, for it is only when a person's resources are limited that a person must choose among competing alternatives. Micro-economics is based upon the principle that economic decisions (i.e. choices) are made by weighing cost against benefit.

As discussed below, economics is the study of how rational decisions are made by individuals. Law, in the concept of the reasonable person, presupposes that people are capable of rational, that is reasoned (hence reasonable) behavior. It is true that there is a fundamental difference between the conceptualization of reasoned behavior on the part of economists and lawyers.[21] While not altruistic, the reasonable person is solicitous of the welfare of others; the rational person seeks only to maximize his personal welfare. Yet the rational person may in some respects be portrayed as a simplified version of the reasonable person—a person abstracted from reality for the purpose of study and theory de-

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21 As Robert Cooter points out in a commentary [(1983) 33 *J. Legal Education* 237], the law is concerned both with the reasonableness of the end and the means. Economists tend to ignore the end, and focus entirely on whether the means to that end are consistent with its attainment.

velopment. Analysis of rational decision making in pursuit of a single objective (the welfare of the rational person), may well lead to a deeper understanding of the process of reasonable decision making, in which competing objectives are brought into play. At any rate, it is certainly a more systematic approach to the question of reasonable behavior to ask how a rational person who consistently pursues a specified end would behave in particular circumstances than to do no more than make *ad hoc* assumptions concerning the reasonableness of particular behavior by reference to no fixed standard at all.

### *The concept of rational decision making*

At its most fundamental level, economics is the study of rational decision making—or, as some would have it, bounded rational decision making. Thus in the introduction to his *Principles of Economics,* Alfred Marshall explained the basic nature of economic theory:[22]

> Political economy or economics is a study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of wellbeing. Thus it is on one side a study of wealth; and on the other, and more important side, a part of the study of man. For man's character has been moulded by his every day work, and the material resources which he thereby procures, more than by any other influence unless it be that of his religious ideals.

Since society has limited resources, people are required to make rational choices concerning the many competing uses to which those resources may be put. It is the process of making those choices which forms the basis of economic thinking. In contrast to law, economics is not concerned with the study of human behavior at the individual level; it is the study of such behavior in the aggregate. In order to permit systematic study of human behavior, simplified models are created, and for this reason economic theory is based on an abstraction of human behavior. The premise on which all such theories is based is that individual decisions are made in a rational manner.

What is meant by rationality? The term 'rational' is derived from 'ratio', which is a mathematical term signifying a relationship of the

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22 See Marshall, Alfred, Principles of economics, 8th edn, London, McMillan.

magnitude or proportion of one quantity to another.[23] Within the context of the behavioral sciences, rationality is the relationship that exists between the goals of a person (the 'actor') and the decisions and acts of that person. In general, acts or decisions may be said to be rational where they can be shown to relate to each other or to some pre-defined goal. Unfortunately, it is difficult to move from this general definition to a more precise one, for the term 'rational' has diverse meanings in each of economics, philosophy, logic and psychology.

At its most basic level, acts or decisions may be said to be rational provided they are the product of conscious choice and are not mutually inconsistent. For example, a person who goes for a walk would be irrational if he or she tried to head in several different directions. Provided, however, that the person follows a discernible path (even a circuitous one, as opposed to random motion), the decisions made during the walk are rational, even if there was no particular reason for going on the walk in the first place and the walker is not seeking to reach any specified place.

At a slightly more advanced level, not only must the decisions be conscious and not be inconsistent in order to be rational, but they must also be pursued with a view toward obtaining an identified objective. In other words, the actor must know what he (or she) is trying to accomplish, and must select what he believes to be the most appropriate strategy to accomplish that goal. Under this definition, going for a walk is only rational if there is a reason for going for the walk and the walker follows a discernible path. At these two elementary levels, note that we are concerned only with the rationality of the act within a given belief system. In other words, the beliefs of the actor may have little foundation in reality, but the acts and decisions of the actor may still be seen as rational provided he believes that his acts or decisions are consistent with the end that he seeks. If the plaintiff believes that going for a daily walk will ensure a good harvest, the plaintiff still is behaving rationally provided the reason the plaintiff is going for a walk is to increase the chances of such a harvest.

In contrast, at the third level, decisions are only rational when they are likely to promote the attainment of a specified goal, as determined

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23 That is why numbers that can be reduced to the form a/b are said to be rational numbers. It is not that these numbers are more logical than other numbers, but merely that they have a clearer relationship to each other.

by a sound and systematic analysis of the problem to which they relate. In other words, not only is the decision or act intended toward a given end, and not inconsistent with the attainment of that end, but the decision or act must actually work towards that end. At this level, decisions are only rational if they are based on a rational belief system. But what is such a belief system? Is a belief system rational only if it is based upon the actor's personal experience? Or may it be based upon a collective body of wisdom that the actor shares with other members of society? Most people would likely accept the shared common body of wisdom as acceptable. But then there are other options that present themselves for consideration: may this collective body of wisdom be based upon faith, or is it necessary that it be objectively verifiable.

Quite often inherited belief systems are entirely mistaken, and the extent of the error on which they are founded becomes progressively more evident as new discoveries are made. The Ptolomeic conception of an Earth-centred universe provides a case in point. Yet those who opt for an objectively and directly verifiable belief system must confront the fact that very few of our beliefs are capable of such proof. At best, most of our scientific beliefs are proven only in the sense that they conform with available data and have been found to predict subsequent events with reasonable accuracy. Moreover, since no one is in a position to retest all previous findings, for the most part nearly all of our beliefs are accepted on a basis of faith in the honesty and ability of previous researchers.

To digress further into these questions would be to embark on a detailed inquiry into the philosophy of science. For the moment, it is sufficient to note that they are merely questions that need to be answered at the third level of rationality. The term 'rational behavior' when used in economics generally describes behavior at or close to the third level of rationality. Although many people identify economic decision making with wealth maximization, the focus of economics is not money so much as utility. The basic assumption of economics is that individuals seek to maximize their overall level of satisfaction or personal feeling of well-being—in other words, given two options, each person is likely to prefer one to the other and if allowed to chose between them, each person will likely chose the preferred option over the less preferred option. An option that is preferred is said to have greater utility than the option(s) that is not preferred. In measuring the degree of preference at-

tached to various options, a person is said to rank the utility that each of those options presents.[24]

Economic theory does not argue that people should maximize their individual utility; it is simply assumed (for analytical purposes) that this is what they tend to do. In many respects that assumption is likely to be reasonable. While people do sometimes act in an altruistic manner, so long as human nature remains what it is altruistic behavior is likely to be the exception rather than the rule. Many no doubt would argue that the law should encourage people not to be selfish. However, it is one thing for the law to encourage selfless behavior; it is quite another to structure a legal system on the assumption that such behavior is the norm.

While economic theory essentially assumes rationality at the third level, in many respects the legal system considers rationality at an even higher, fourth level. At this fourth level for acts and decisions to be considered rational they must not only promote the attainment of a specified goal, as determined by a sound and systematic analysis of the problem to which they relate, but the goals themselves must also be rational. Hitler's 'Final Solution' would be the archetype of a policy that would definitely not be rational under the fourth standard: the goal of the policy was clear, it was consistently and vigorously pursued, and the methods employed in its execution were determined by sound and systematic analysis. But the objective of the policy was morally repugnant (to say the least) and wholly perverse. To describe the Final Solution as rational would be idiotic.[25] The distinction between rational behavior at the third level and rational behavior at the fourth is that at the fourth level the goal itself must be selected on the basis of sound and system-

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24 In the seminal work in this area of study, Jeremy Bentham described such satisfaction as 'utility', from which the word and concept of utilitarianism has sprung: Bentham, J., 1848, Introduction to the Principles of Morals and Legislation, Hafner, London.

25 Tragically, it was in large measure because the Final Solution was so systematically (i.e. 'rationally') applied that it was both so vile and so horrifyingly successful.

atic analysis. Moreover, the goal must also be consistent with the general cultural, social and moral norms of the society concerned.[26]

Since the legal system and economic theory conceive of rationality in somewhat different terms, does it still follow that economic analysis can play a useful role in resolving legal issues. Two arguments can be advanced to show that it can. First, most people would agree that most of their actions are intended to maximize their level of self-satisfaction. Few people are saints all or even most of the time. Where the advancement of self is the goal, there is a clear value to the study of rational decision making in the economic sense. Moreover, we are further advantaged in this respect by the fact that relatively few choices require us to select between good and evil. No one ever went to hell because they preferred ketchup to gravy, or even because they loathed both. Where presented with a choice between ketchup and gravy, a person is free to decide which of the two they prefer, few people will consider the question to be one that involves a weighty moral choice. The decision is likely to be one of pure personal taste, and will be made without any pangs of moral conscience.

Second, despite the fact that all people are to some extent the slaves of emotion or instinct, a substantial amount of daily activity consists of voluntary choices between options concerning which we are generally selection neutral. In other words, if I wish to buy a means of transportation, I have no instinctive preference towards a car or a horse, and I am much less likely to have any instinctive preference between a Ford or a Holden. Moreover, my decision as to whether to buy one economics text book or another I am not likely to be caught up in emotion over the thought of the transaction. In each of these cases my decision is likely to be more rational than emotional or instinctive, with the rationale of the choice being which of the competing options most suits my budget and other requirements and thereby enables me to maximize my self-satisfaction.

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26 While the Final Solution may be viewed as an example of irrational decision making at the macro (or state) level, most criminal activity may be viewed as an example of irrational conduct at the micro (or individual) level.

### The arguments in favour of the use of economic analysis in the study of law

We can therefore draw the conclusion that in most cases there is little difference between the economic and legal conceptions of rationality: what is rational behavior for the economist will generally be reasonable behavior for the lawyer. But even if the differences between the legal and economic concepts of rationality are accepted, arguments exist for the use of economic analysis as an analytical tool in the study of law. The primary justification for the use of economics is that by studying the effect of particular rules of law on rational decision making, economics permits laws to be examined in a more comprehensive way than is possible solely through a black letter examination of the law. For instance:

(a) Economic analysis permits laws to be examined in terms of the interaction between a system of rules and the behavior of individuals who are affected by those rules. The rules are seen not only as awarding rights and imposing liabilities, but in terms of the costs that they impose, their effect upon returns to the individual, and the interactions among individuals that likely will occur as a result of those costs and wealth effect. The utility (or, more vulgarly, profit maximization) assumption allows systematic inquiry into effect by providing a consistent analytical framework for the examination that is undertaken.

(b) Since human behavior is multidimensional, the general equilibrium methodology used in economic analysis can reveal how the regulation of one dimension of activity may affect other dimensions of activity. Such coincident effects are clearly relevant to legal decision making, yet for the most part traditional legal analysis has rarely looked beyond the effect of a decision upon the immediate parties to a dispute or matter. Certainly in the case of judges and other adjudicators, it is important that they see not only how their decisions will affect the parties before them, but other parties as well, and it is equally important that the lawyers appearing before them be able to present such an analysis.

(c) Economic analysis focuses attention on marginal effect: the incremental effect of changes in a system that is otherwise stable, as

for instance the effect of an increase or decrease of one unit in the level of production, consumption or saving. Traditionally, legal scholarship has paid little attention to the incremental effects of changes.[27] Marginal analysis is critical to understanding the effects of a change in the law, and may provide a more accurate assessment of the effect of a legal incentive on behavior than a study of gross or average effects.

(d) Through the use of model building techniques, economic analysis allows systematic inquiry into the effect of changes in the law to be conducted in advance. It is possible to predict responses to changes in the law based upon assumptions concerning human behavior. Thus it differs from traditional black letter legal analysis which is *ex post* in approach, focusing primarily upon past events. Yet, paradoxically, economics is also more systematic in *ex post* analysis than black letter law. Black letter law is almost exclusively preoccupied with the study of anecdotical examples based upon cases which eventually progress to final adjudication by the courts. In contrast, through the techniques of econometrics, it is possible to assemble and analyze global or representative data in a much more systematic way than is possible through traditional black letter law methods. In this way, lawyers can move beyond the traditional limits of their discipline, which have seen them almost inextricably wedded to anecdotal evidence and casual empiricism.

(e) Economic analysis provides a method for comparing on a systematic basis the effect of alternative legal regimes and institutional arrangements. The imperfection of any legal system may be taken for granted. However, it is important to strive for a system that is the most perfect of available systems. Economic analysis does provide one method of comparing the performance or expected performance of alternative regimes.

Ultimately, economic analysis may improve the clarity and logic of legal argument and rules. In the past, many laws have been based primar-

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27 Gelhorn, E. & Robinson, G.O., 'The Role of Economic Analysis in Legal Education' (1983) 33 *J. Leg. Ed.* 247 at 251.

ily upon assumptions of market condition and of effect. Economic analysis allows those assumptions to be tested, and such testing has called many cherished notions of the legal community into question and is forcing us to rethink many of the rules of law that have evolved,[28] not only in the case of statute law, but also in the case of judge made law. One can point, for instance, to Fredreich Kessler's highly influential article on standard form contracts[29] as an example of the type of legal scholarship which economic analysis has allowed to be thoroughly re-examined and discredited. Kesler's unsubstantiated and inexact conceptions of market failure would not pass academic muster today - not necessarily because he came to the wrong conclusions, but because he failed to provide an adequate theoretical or empirical foundation for the conclusions that he reached.

Moreover, formulation of legal rules in the form of economic formulae, as in the case of the so-called Hand rule, can in some cases bring legal concepts, such as reasonable care and reasonable precaution, into more meaningful focus. The economic expression of negligence and strict liability rules can make the distinction between these two bases of liability clearer. Experience shows that courts often have difficulty in drawing a clear analytical distinction between these two liability concepts as well as difficulty in applying them. For instance, studies in the United States have shown that some courts have applied a negligence based liability system in product liability cases, even though they have believed that they were applying a strict liability standard.[30]

### *The use of economic reasoning in judicial decision making*

As indicated above, Chief Justice Mason appears to reject the use of economic reasoning by the courts in large part because it would depart from traditional methodology employed in the courts. Yet there are

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28 In some cases, the analysis has confirmed the approach taken: compare Douglas, W.O., 'Vicarious Liability and Administration of Risk' (1929) 38 *Yale L. J.* 584 with G. Calabresi, 'The Costs of Accidents: A Legal and Economic Analysis' (1970) *Yale Univ. Press,* New Haven, Conn., and R. Posner, 'A Theory of Negligence' (1972) 1 *J. Leg. Stud.* 39.

29 'Contracts of Adhesion—Some Thoughts About Freedom of Contract' (1943) 43 *Colum. Law Rev.* 629.

30 'Strict Products Liability and the Risk-Utility Test for Design Defects: An Economic Analysis' (1984) 84 *Colum. L. Rev.* 2045.

many instances where the courts have expressly or impliedly based their decisions almost entirely upon economic or other social policy considerations. For instance in *Printing & Numerical Registering Co. v. Sampson*,[31] Jessell MR rejected the notion that public policy provided a general basis for invalidating contracts that appeared unduly harsh to one of the parties, when he stated:

> It must not be forgotten that you are not to extend arbitrarily those rules which say that a given contract is void as being against public policy, because if there is one thing which more than another public policy requires is that men of full age and competent understanding shall have the utmost liberty contracting and that contracts when entered into freely and voluntarily shall be held sacred and shall be enforced by courts of justice.

This view prevailed to the end of the 19th Century and even well into the 20th Century. As recently as 1923, the New Zealand Court of Appeal stated:[32]

> The mere fact that a transaction is based on inadequate consideration is otherwise improvident, unreasonable, or unjust is not in itself any ground on which this court can set it aside as invalid. Nor is such a circumstance in itself even a sufficient ground for a presumption that a transaction was the result of fraud, misrepresentation, mistake or undue influence, so as to place the burden of supporting the transaction upon the person who profits by it. The law in general leaves a man at liberty to make such bargains as he pleases, and to dispose of his own property as he chooses. However improvident, unreasonable, or unjust such bargains or dispositions may be, they are binding on every party to them unless he can prove affirmatively the existence of one of the recognized invalidating circumstances, such as fraud or undue influence.

The reason why the courts took such positions was overtly economic, as the words of Latham CJ in *Wilton v. Farnworth*[33] attest: 'any weakening of these principles would make chaos of every day business transactions.' Thus the general principle that contracts are binding according to their terms derives in large measure from express economic considerations.

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31 (1875) LR 19 Eq. 462 (CA) at 465.

32 *Brusewiz v. Brown* [1923] NZLR 1106, per Salmond J at 1109.

33 (1948) 76 CLR 646 (HC Aust.), at 649.

Similarly, many of the rules relating to consideration have an economic foundation. For instance, in *Harris v. Watson*[34], Lord Kenyon refused to enforce a promise made by a captain to pay a seaman 5 guineas over and above his agreed wage on the basis that to give effect to such promises would 'materially affect the navigation of this kingdom' by allowing seamen in times of danger to insist upon an extra payment in order to do the work that they had agreed to perform. The reason for the non-suit was essentially an economic one: the risk of undermining the economics of navigation if such promises were enforced.

Nor has the use of economic considerations in giving judgment been limited to the field of contract. Economic considerations weighed heavily on 19th Century judges, called upon to decide among conflicting property entitlements as a result of the large number of nuisance cases resulting from the radical transition from agrarian to industrial society through which the English speaking world moved at that time.[35]

In his lecture, the Chief Justice made a number of references to *Donoghue v. Stevenson*[36], a decision which he clearly holds in high esteem. Negligence did not originate in that case, however, but evolved slowly over a long period. Almost from its inception, however, implicit consideration was given to the economic element of the tort. For instance, the classic general definition of negligence given by Alderson B in *Blyth v. Birmingham Waterworks Co.*,[37] reads:

> Negligence is the omission to do something that a reasonable man, guided upon those considerations which ordinarily regulate the conduct of human affairs, would do, or doing something which a prudent and reasonable man would not do.

Since human affairs are in large measure regulated by the economic constraints to which all people are subject, it would be the height of fantasy to suggest that cost and benefit are not relevant to the determination of whether particular conduct is reasonable or negligent.

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34 170 ER 94 (NP).

35 See, for instance, the judgment of Bramwell, B. in *Brand v. Hammersmith & City Rlwy Co.* (1867) LR 2 QB 223 (Ex. Ch.) at 231.

36 [1932] AC 562; All ER Rep 1 House of Lords.

37 (1856) 11 Ec. 781.

Although it is true that in *Donoghue v. Stevenson*[38] itself economic reasoning played little if any part in the decision of the House of Lords, the decision at which they arrived is fully consistent with economic principles. More importantly, the decision was based almost entirely in social policy considerations. Negligence is still very much influenced by the decision of Lord Atkin in *Donoghue v. Stevenson,*[39] where he stated:

> The law of both [Scotland and England] appears to be that in order to support an action for damages for negligence, the complainant has to show that he has been injured by a breach of duty owed to him in the circumstances by the defendant to take reasonable care to avoid such injury.... The liability for negligence, whether you style it such or treat it as in other systems as a species of 'culpa', is no doubt based upon a general public sentiment of moral wrong-doing for which the offender must pay. But acts or omissions which any moral code would censure cannot in a practical world be treated so as to give a right to every person injured by them to demand relief.... The rule that you are to love your neighbour becomes in law, you must not injure your neighbour; and the lawyer's question, Who is my neighbour? receives a restricted reply. The answer seems to be—persons who are so closely and directly affected by my act that I ought reasonably to have them in contemplation as being so affected when I am directing my mind to the acts or omissions which are called in question.

Once public policy becomes the foundation of a rule, there is no reason to exclude economic considerations from the decision making process.

If the foundation of negligence is the breach of a duty to take reasonable care to avoid injury to others, the obvious question then becomes what is the meaning of reasonable care. As economics is focused on rational behavior, it can provide significant guidance in that regard. Thus the Chief Justice was mistaken in his implicit assumption that the use of economic analysis is out of place in judicial decision making. It has always played an important role and whether or not the Chief Justice likes it, it shall always play an important role so long as resources remain scarce relative to demand. Since economic considerations are relevant to judicial decision making, it is important that judges

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38 [1932] AC 562; All ER Rep 1 House of Lords.

39 Ibid.

learn to identify economic issues, and to be trained in the systematic analysis of these issues.

### *A primer on estoppel: the Waltons Stores decision in law & economics*

The undesirable consequences of deliberate rejection of economic analysis in legal reasoning become evident in analyzing the decision of the High Court in *Waltons Stores*.[40] Let me begin by saying that I do not take issue with the result which the High Court reached in that case. The basic problem with the decision is the vague basis on which that result rests. In charting any new direction in the law, it is essential that the High Court provide sharp guide-lines so that lower courts may understand the direction that they are to take in applying the new law handed down by the High Court. This the High Court simply did not do.

To undertake any meaningful review of the High Court decision in *Waltons Stores*, it is first necessary to place that decision within its proper context, which is the law of promissory estoppel. Simply defined, estoppel is a rule which prevents a person from denying the truth of a statement that he has made or from denying facts that he has alleged or suggested to exist. Traditionally, estoppel has been viewed as providing a shield rather than a sword—meaning that it affords a defence to a claim but cannot be invoked as the basis of a claim. The significance of the *Waltons Stores* case is that it allows estoppel to be invoked as a cause of action, at least in certain limited circumstances.

There are numerous categories of estoppel and to an extent these various categories sometimes overlap. The three main categories of estoppel are estoppel by record, by deed and *in pais* (the last meaning no more than 'by conduct'), the latter being of prime concern in the *Walton Stores* case. Estoppel by conduct arises against a person who has by his or her words or conduct wilfully or by negligence caused another person to believe a certain state of things and induces the other to act on that belief so as to alter his or her previous position. The requirements for an estoppel by conduct are:[41]

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40 (1988) 164 CLR 387 (H.C. Aust.).

41 *Greenwood v. Martin's Bank* [1933] AC 51 (HL), per Lord Tomlin at p. 57.

(a) a representation or conduct amounting to a representation intended to induce a course of conduct on the part of the person to whom the representation is made;

(b) an act or omission resulting from the representation by the person to whom the representation is made, provided that this resulting act or omission must occur before the representation is corrected;

(c) detriment to the person to whom the representation is made, as a consequence of his act or omission in reliance on the representation;

(d) generally, mere silence cannot amount to a representation unless there is a duty to disclose, in which case deliberate silence may become significant and amount to a representation.

Under equitable estoppel, a person who stands by and keeps silent when he observes another person acting under a misapprehension or mistake, which he could have prevented by speaking up concerning the true state of affairs, may be estopped from later alleging the true sate of affairs. For instance, if the plaintiff, the true owner of a property, willingly allows another person, the defendant, to build on the property on a mistaken assumption that the property actually belongs to the defendant, then under equitable estoppel the plaintiff may not subsequently bring an action in trespass against the defendant.[42]

One of the clearest expositions of the law relating to estoppel may be found in the decision of Dixon J in *Thompson v. Palmer*:[43]

> The object of estoppel *in pais* is to prevent an unjust departure by one person from an assumption adopted by another on the basis of some act or omission which, unless the assumption be adhered to, would operate to that other's detriment. Whether a departure by a party from the assumption should be considered unjust and inadmissible depends on the part taken by him in occasioning its adoption by the other party. He may be required to abide by the assumption because it formed the conven-

42 *Chalmers v. Pardoe* [1963] 1 WLR 677; [1963] 3 All ER 552 (PC), per Sir Terrence Donovan at 98.

43 (1933) 49 CLR 507 (HC Aust.) at 547.

> tional basis upon which the parties entered into contractual or other mutual relations, such as bailment; or because he has exercised against the other party rights which would exist only if the assumption were correct, ... or because knowing the mistake the other laboured under, he refrained from correcting him when it was his duty to do so; or because his imprudence, where care was required of him, was a proximate cause of the other party's adopting and acting upon the faith of the assumption; or because he directly made representations upon which the other party founded the assumption. But, in each case, he is not bound to adhere to the assumption unless, as a result of adopting it as the basis of action or inaction, the other party will have placed himself in a position of material disadvantage if departure from the assumption be permitted.

Four years later in *Grundt v. Great Boulder,*[44] Dixon J returned to this theme, but in slightly different language:

> The principle upon which estoppel *in pais* is founded is that the law should not permit an unjust departure from an assumption of fact which he has caused another party to adopt or accept for the purpose of their legal relations.... One condition appears always to be indispensable. That other party must have so acted or abstained from acting upon the footing of the state of affairs assumed that he would suffer a detriment if the opposite party were afterwards allowed to set up rights against him inconsistent with the assumption. In stating this essential condition, particularly where the estoppel flows from representation, it is often said simply that the party asserting the estoppel may have been induced to act to his detriment. Although substantially such a statement is correct and leads to no misunderstanding, it does not bring out clearly the basal purpose of the doctrine. That purpose is to avoid or prevent a detriment to the party asserting the estoppel by compelling the opposite party to adhere to the assumption upon which the former acted or abstained from acting. This means that the real detriment or harm from which the law seeks to give protection is that which would flow from the change of position if the assumption were deserted that led to it. So long as the assumption is adhered to, the party who altered his situation upon the faith of it cannot complain. His complaint is that when afterwards the other party makes a different state of affairs the basis of an assertion of right against him then, if it is allowed, his own original change of position will operate as a detriment. His action or inaction must be such that, if the assumption upon which he proceeded were shown to be wrong and an

44 (1937) 59 CLR 641 (HC Aust.) at 674-75.

> inconsistent state of affairs were accepted as the foundation of the rights and duties of himself and the opposite party, the consequence would be to make his original act or failure to act a source of prejudice.

The reference to an unjust departure in the above quotations was not seen by Dixon J as a charter for idiosyncratic concepts of justice and fairness.[45] He made this clear in the *Grundt*, decision, where he stated:[46]

> The justice of an estoppel is not established by the fact in itself that a state of affairs has been assumed as the basis of action or inaction and that a departure from the assumption would turn the action or inaction into a detrimental change of position. It depends also on the manner in which the assumption has been occasioned or induced. Before anyone can be estopped, he must have played such a part in the adoption of the assumption that it would be unfair or unjust if he were left free to ignore it. It defines with more or less completeness the kinds of participation in the making or acceptance of the assumption that will suffice to preclude the party if the other requirements for an estoppel are satisfied.

In order for estoppel to come into play, the representation made by the promissor must be unambiguous.[47] The representation must be of a sort that would reasonably be understood in only a single sense by the person to whom it was made.[48] Moreover, it is essential to show that the statement was of such a nature that it would have misled any reasonable person, and the plaintiff must show that he was in fact misled by it.[49] So in *Woodhouse Ltd v. Nigerian Produce Ltd*,[50] Lord Denning said:

> If the representation is put forward as a *variation,* and is fairly capable of one or other of two meanings, the judge will decide between those two meanings and say which is right. But, if it is put forward as an *estoppel,* the judge will not decide between the two meanings. He will reject it as

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45 *Legione v. Hately* (1983) 152 CLR 406, per Mason and Deane JJ at 408.

46 (1987) 59 CLR 641 at 675-76.

47 *Western Australian Insurance Co. Ltd v. Dayton* (1924) 35 CLR 355 (HC Aust.), per Isaacs ACJ at 375.

48 *Low v. Bouvier* (1891) 3 Ch 82 (CA), per Bowen LJ at 106.

49 Id, per Kay LJ at 113.

50 [1971] 2 QB 23 (CA), per Lord Denning MR at 60.

> an estoppel because it is not precise and unambiguous. There is good sense in this difference. When a contract is *varied* by correspondence, it is an agreed variation. It is the duty of the court to give effect to the agreement if it possibly can: and it does so by resolving ambiguities, no matter how difficult it may be. But, when a man is *estopped*, he has not agreed to anything. Quite the reverse. He is stopped from telling the truth. He should not be stopped on an ambiguity. To work an estoppel, the representation must be clear and unequivocal.

In *Legione v. Hately*,[51] Mason and Deane JJ elaborated on this requirement both in the context of common law and promissory estoppel:

> The requirement that a representation as to existing fact or future conduct must be clear if it is to be found to be an estoppel *in pais* or a promissory estoppel does not mean that the representation must be express. Such a clear representation may properly be seen as implied by the words used or to be adduced from either failure to speak where there was a duty to speak or from conduct. Nor is it necessary that a representation be clear in its entirety. It will suffice if so much of the representation as is necessary to found the propounded estoppel satisfied the requirement. Thus a representation that a particular right will not be asserted for at least x days is not rendered, for the purposes of promissory estoppel, unclear or unequivocal merely because the words used are equivocal as to whether the relevant period is x days, x plus one days or x plus two days. If what is said or done amounts to a clear and unequivocal representation that the particular right will not be asserted for a period of at least x days, a representation to that effect can be relied on to found an estoppel.

In *Jorden v. Money*[52], the House of Lords ruled that common law estoppel applied only to statements of fact and not to promises of future conduct—thus appearing to rule out a basis for promissory estoppel. A similar view was expressed some years later (albeit tangentially) in *Maddison v. Alderson*,[53] where an intestate person induced a woman to serve him as his housekeeper for many years without wages, and to give up other prospects of establishment in life. He did so by making an oral promise to make a will in her favour, leaving her a life estate in certain

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51 [1983] 152 CLR 406

52 (1854) 5 HLC 185, 10 ER 868 (HL).

53 (1883) 8 App Cas 467.

land. The intestate did sign a form of will providing for this estate, but it was not duly attested and was therefore invalid. The House of Lords (which quite clearly doubted the truth of the woman' s story[54]) held that there was no contract, but that even if there was a contract, and even if the woman had given the consideration stipulated, her service was not unequivocally and in its own nature referable to the contract, and was not as such part performance so as to remove it from the operation of section 4 of the *Statute of Frauds.* In his opinion, the Lord Chancellor specifically rejected the notion that promissory estoppel could serve as the basis of the claim, stating:[55]

> I have always understood it to have been decided in *Jorden v. Money* that the doctrine of estoppel by representation is applicable only to representations as to some state of facts alleged to be at the time actually in existence, and not to promises *de futuro* which, if binding at all, must be binding as contracts.

The restriction of common law estoppel to representations of existing fact was found to be impractical in a good many cases. Slowly but steadily over the years, a new doctrine began to emerge: the doctrine of promissory estoppel. The basis for this new doctrine may be found in the decision of Lord Cairns in *Hughes v. Metropolitan Railway.*[56] In that case, a landlord gave his tenant six month's notice to repair the leased premises. The notice specified that if the tenant failed to comply with it, the lease could be forfeited. A month later, the tenant wrote to the landlord inquiring into the possibility of selling the lease back to the landlord, and proposing to defer the making of the repairs until it learned of the landlord's wishes in this regard. A few days later, the landlord's lawyers wrote to the tenant and enquired what price the tenant was prepared to offer—this price being provided some three weeks later. The day following receiving the proposed price, the landlord's lawyers wrote back rejecting the offer. As the repairs were not made within the six month period following the date of the landlord's original notice, the landlord sought to bring an action for ejectment. The House

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54 See, for instance, the decision of Lord Fitzgerald Id at 492; per Lord O'Hagan at 486.

55 Id per Earl of Selborne LC at 473.

56 (1877) 2 App Cas 439 (HL) at 448.

of Lords held that by entering into negotiations in response to the tenant's proposal to sell, the landlord had first waived the portion of the six month notice period which had expired under the original notice, and second impliedly represented that the operation of the notice was suspended during the course of negotiation. With respect to the issue of promissory estoppel, Lord Cairns stated:

> It is the first principle upon which all courts of equity proceed, that if parties who have entered into definite and distinct terms involving certain legal results..., afterwards by their own act or with their own consent enter upon a course of negotiation which has the effect of leading one of the parties to suppose that the strict rights arising under the contract will not be enforced, or will be kept in suspense' or held in abeyance, the person who might otherwise have enforced those rights will not be allowed to enforce them when it would be inequitable having regard to the dealings which have thus taken place between the parties.

Similarly, in *Birmingham and District Land Co. v. London & North Western Railway Co.*,[57] Bowen LJ stated:

> ... if persons who have contractual rights against others induce by their conduct those against whom they have such rights to believe that such rights will either not be enforced or will be kept in suspense or abeyance for some particular time, those persons will not be allowed by a Court of Equity to enforce the rights until such time has elapsed, without at all events placing the parties in the same position as they were before.

Despite some waffling in the Privy Council,[58] this new principle stuck[59] and was applied not only to suspend strict rights, but also to preclude enforcement of them.[60] An essential difference between common law estoppel and equitable estoppel is that the former is a rule

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57 (1888) 40 Ch D 268 (CA) at 286.

58 *Chadwick v. Manning* [1896] AC 231, per Lord Macnaghten at 238.

59 See, for instance, *Tool & Metal Manufacturing Co. Ltd v. Tungsten Electric Co. Ltd* [1955] 1 WLR 761, at 763-4, 783, 798-99; *Ajayi v. R.T. Bricoe (Nigeria) Ltd* [1964] 1 WLR 1326 at 1330; *Woodhouse Ltd v. Nigerian Produce Ltd* [1972] AC 741 at 755-56.

60 *D & C Builders Ltd v. Rees* [1966] 2 QB 617 (CA), per Lord Denning MR.

of evidence while the latter is a foundation of rights.[61] In the *Waltons Stores* case, Brennan J discussed this aspect of equitable estoppel:[62]

> ...Unlike an estoppel *in pais*, an equitable estoppel is a source of legal obligation. It is not enforceable against the party estopped because a cause of action or ground of defense would arise on an assumed state of affairs; it is the source of a legal obligation; it is the source of a legal obligation arising on an actual state of affairs. An equitable estoppel is binding in conscience on the party estopped, and it is to be satisfied by that party doing or abstaining from doing something in order to prevent detriment to the party raising the estoppel which that party would otherwise suffer by having acted or abstained from acting in reliance on the assumption or expectation which he has been induced to adopt. Perhaps equitable estoppel is more accurately described as an equity created by estoppel.

*Waltons Stores* essentially concerns the rise of promissory estoppel as the basis of an independent and sufficient cause of action. The evolution of promissory estoppel into such a cause really begins with the decision of the Court of Appeal in *Central London Property Trust Ltd. v. High Trees House Ltd.*[63] In that case, the plaintiffs granted the defendant company (a subsidiary of the plaintiffs) a tenancy of a block of flats for 99 years at a ground rent of £2500 per year. Some time later, the rent was reduced to £1250, due to the decline in demand for such properties resulting from war conditions. The defendant paid the reduced rent from 1941 to 1945, by which time all of the flats were let. When the plaintiff was placed into receivership, the receiver wrote to the defendants and demanded payment of the full rent, and claimed £7,916 as arrears of rent owing. In the course of holding the promise of reduced rent binding, Denning J considered the rule in *Jorden v. Money,* and stated:

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61 See, generally, *In Re Ottos Kopje Diamond Mines Ltd.*

62 *Waltons Stores (Intertate) Ltd v. Maher & Anor* (1988) 164 CLR 387 at 416.

63 [1947] KB 130 (KB).

> The law has not been standing still since *Jorden v. Money.* There has been a series of decisions over the last 50 years, which although they are said to be cases of estoppel are not really such. They are cases in which a promise was made which was intended to create legal relations and which, to the knowledge of the person making the promise, was going to be acted on by the person to whom it was made, and which was in fact so acted on.... As I have said they are not cases of estoppel in the strict sense. They are really promises—promises intended to be binding, intended to be acted on, and in fact acted on. *Jorden v. Money* can be distinguished, because there the promissor made it clear that she did not intend to be legally bound, whereas in the cases to which I refer the proper inference was that the promissor did intend to be bound. In each case the court held the promise to be binding on the party making it, even though under the old common law it might have been difficult to find any consideration for it. The courts have not gone so far as to give a cause of action in damages for the breach of such a promise, but they have refused to allow the party making it to act inconsistently with it. The decisions are a natural result of the fusion of law and equity.... In my opinion, the time has now come for the validity of such a promise to be recognized.

Despite the breadth of the language used by the then Denning J in the *High Trees* case, the extent of the enforceability of such promises which he had in mind was highly limited—a point which he made clear four years later in the decision given by the now Denning LJ in *Combe v. Combe*:[64]

> Much as I am inclined to favour the principle stated in the *High Trees* case, it is important that it should not be stretched too far, less it should be endangered. That principle does not create new causes of action where none existed before. It only prevents a party from insisting upon his strict legal rights, when it would be unjust to allow him to enforce them, having regard to the dealings which have taken place between the parties.

While restricting promissory estoppel to a defensive remedy rather than making it the foundation of an action, Denning LJ took care to make clear that it was a principle which could be invoked both by defendants

64 [1951] 2 KB 215 (CA) at 220.

and plaintiffs, so long as it was not made the basis of a cause of action:[65]

> Sometimes it is a plaintiff who is not allowed to insist on his strict legal rights ... On other occasions, it is a defendant ... In none of these cases was the defendant sued on the promise, assurance or assertion as a cause of action in itself; he was sued for some other cause, for example, a pension or breach of contract, and the promise, assurance or assertion only played a supplementary role; an important role, no doubt, but still a supplementary role. That ... is its true function. It may be part of a cause of action, but not a cause of action in itself.

A simple example of a use of a promise as part of a cause of action, but not as the basis of the cause of action, arises where a buyer under a contract for the sale of goods agrees to waive a time limit under the contract for delivery of those goods: he may not afterwards raise the failure to satisfy the time limit in answer to a claim for payment.[66] Thus on these foundations Denning LJ constructed a general principle of promissory estoppel:[67]

> The principle ... is that, where one party has, by his words or conduct, made to the other party a promise or assurance which was intended to affect the legal relations between them and to be acted on accordingly, then, once the other party has taken him at his word and acted on it, the one who gave the promise or assurance cannot afterwards be allowed to revert to the previous legal relations as if no such promise or assurance had been made by him, but he must accept their legal relations subject to the qualification which he himself has so introduced, even though it is not supported in point of law by any consideration but only by his word.

The reason why promissory estoppel could not serve as the basis of an independent cause of action was the insurmountable problem of the requirement for consideration:[68]

> Seeing that the principle ever stands alone as giving a cause of action in itself, it can never do away with the necessity of consideration when that

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65 Ibid.

66 *Charles Rickards Ltd v. Oppenhaim* [1950] I KB 616 at p. 621-23.

67 *Combe v. Combe* [1957] 2 KB 215 (CA) at 220.

68 Ibid.

> is an essential part of the cause of action. The doctrine of consideration is too firmly fixed to be overthrown by a side-wind. Its ill-effects have been largely mitigated of late, but it still remains a cardinal necessity of the formation of a contract, though not of its modification or discharge. I fear it was my failure to make this clear which misled Byrne J in the present case.

Is it analytically sound to restrict promissory estoppel so that it may be a shield but not sword? The distinction between a cause of action and a defence is not always clear, and as a result one practical effect of this restriction is to produce apparently inconsistent results. For instance, if promissory estoppel is so restricted, a tenant who was told by his landlord that he can live in a cottage rent free for a year may raise that promise in defence to a claim brought by the landlord for rent or to evict the tenant.[69] However, if the tenant was not in possession, it would not be possible to sue the landlord on that same promise in order to obtain possession.

In contrast to the difficulties which have confronted English courts in dealing with the enforcement of promises concerning future conduct in the context of the contract law requirement for consideration, under the common law of contract as applied in the United States, promissory estoppel may render a gratuitous promise enforceable as a contract. Section 90 of the *Restatement of Contracts (2d)* outlines the general basis on which such promises will be enforced:

> A promise which the promissor should reasonably expect to induce action or forbearance on the part of the promissee or a third person and which does induce such action or forbearance is binding if injustice can be avoided by enforcement of the promise.

It has been said that the doctrine operates as a substitute for the requirement for consideration,[70] but as in the case of contracts under seal, it is difficult to see how the promise of party $\Delta$ can be equated with consideration given by party $\pi$. If there is any consideration at all which grows out of promissory estoppel, it can only be the conduct undertaken in reliance upon the promise.

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69 *Foster v. Robinson* [1951] I KB 149 at 156.

70 *Allegheny College v. National Chatauqua County Bank* (1927) 246 NY 369, per Cardozo CJ at 374.

A further restriction upon the availability of promissory estoppel is that it may only be invoked where it would be inequitable to give effect to the legal rights of the parties. In *D & C Builders Ltd v. Rees*[71] the defendant's wife compelled the plaintiff to accept £300 in satisfaction of a debt of £482/13/1, by refusing to make any payment unless the offer of £300 was accepted. The defendant's wife knew that the plaintiff faced bankruptcy if it did not get the £300. In rejecting the defendant's claim that promissory estoppel prevented the plaintiff from suing to recover the balance of the account, Lord Denning MR stated:

> In applying this principle, however, we must note the qualification. The creditor is only barred from his legal rights when it would be *inequitable* for him to insist upon them. Where there has been a *true accord,* under which the creditor voluntarily agrees to accept a lesser sum in satisfaction, and the debtor *acts upon* that accord by paying the lesser sum and the creditor accepts it, then it is inequitable for the creditor afterwards to insist on the balance. But he is not bound unless there has ben truly an accord between them. In the present case ... there was no true accord. The debtor's wife held the creditor to ransom. The creditor was in need of money to meet his own commitments, and she knew it.... She was making a threat to break the contract (by paying nothing) and she was doing it so as to compel the creditor to do what he was unwilling to do ... In these circumstances there was no true accord so as to found a defence of accord and satisfaction ... There is also no equity in the defendant to warrant any departure from the due course of law. No person can insist on a settlement procured by intimidation.

### *The High Court beats the shield into a sword*

We have seen how the doctrine of promissory estoppel evolved from the common law concept of estoppel by conduct with respect to existing fact. Cases in which promissory estoppel have been suggested as a suitable foundation for an action were not unknown even in the nineteenth Century. For instance, in *Dillwyn v. Llewelyn*,[72] Lord Westbury stated:

> If A puts B in possession of a piece of land, and tells him, 'I give it to you that you may build a house on it,' and B, on the strength of that promise, with the knowledge of A, expends a large sum of money in building a house accordingly, I cannot doubt that the donee acquires a right from

71 [1966] 2 QB 617 (CA).

72 (1862) DeG.F&J & 517 at 521; 45 ER 1285 at 1286.

> the subsequent transaction to call on the donor to perform that contract and complete the imperfect donation which was made.

Similarly, in *Ramsden v. Dyson,* Lord Kingsdown stated:[73]

> If a man, under a verbal agreement with a landlord for a certain interest in land, or, what amounts to the same thing, under an expectation, created or encouraged by the landlord, that he shall have a certain interest, takes possession of such land, with the consent of the landlord, and upon the faith of such promise or expectation, with the knowledge of the landlord, and without objection by him, lays out money upon the land, a court of equity will compel the landlord to give effect to such promise or expectation.

Nevertheless, until quite recently within the Commonwealth the courts displayed a singular unwillingness to allow it as the basis of a cause of action, so that promissory estoppel was limited to a defensive role, and could not serve as the basis for a claim.

This restriction of the doctrine to has come under question recently as a result of the decision of the Australian High Court in *Waltons Stores (Interstate) Limited v. Maher & Another.*[74] In that case the defendant was a company which had negotiated with the plaintiffs (who were owners of certain land) concerning the possibility of leasing that land. The basic terms of an agreement were formed. These included a requirement that the plaintiffs demolish a building on the land and construct a new one to the defendant's specifications, following which the defendant would lease the building. The defendant's lawyer (Dawson Waldron) sent a draft lease to the plaintiffs' lawyer (Morton & Harris), who suggested certain amendments. On November 7, the plaintiffs' lawyer told the defendant's lawyer that it was essential that the agreement be concluded within a few days otherwise the owner would be unable to organize building supplies before the Christmas closure. He also made clear that the plaintiffs did not wish to demolish the building until it was clear that the defendant would lease the building. The defendant's lawyer told the plaintiffs' lawyer that the defendant had notified him orally that the proposed amendments were acceptable, and he undertook to get formal instruction and to tell the plaintiffs' lawyer the next day

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73 (1866) LR 1 HL 170.

74 (1988) 164 CLR 387.

whether the defendant disagreed with any of them. The defendant's lawyer did not report any objections to the proposed amendments, and indeed there was no communication from the defendant's lawyer to the plaintiffs' lawyer until January 19 of the following year.

In the meantime, a redrafted lease incorporating the proposed amendments was prepared. On November 11, the plaintiffs executed the revised lease, and his lawyer forwarded it to the defendant's lawyer 'by way of exchange'. The plaintiffs then began to demolish the building. About a week later, the defendant decided that it did not want to proceed with the project. The defendant was advised by its lawyer that it was not bound to proceed with the lease unless it executed and delivered the lease. The defendant instructed its lawyer to 'go slow'. When it gave that instruction, the defendant did not know that demolition had begun, although it so learned shortly afterwards. The plaintiffs continued work on the new building. On January 19, when the new building was about 40 per cent complete, the plaintiffs were notified by the company that it did not intend to proceed.

Ultimately the full panel of the High Court ruled in favour of the plaintiffs, although four different opinions were delivered by the five justices. Mason CJ, Wilson, Brennan and Deane JJ concluded that the defendant was estopped from retreating from its implied promise to complete the contract because, knowing the owner-plaintiffs were exposing themselves to detriment by acting on the basis of a false assumption, it was unconscionable for the defendant to adopt a course of action which encouraged the plaintiffs to continue in the course that they had adopted. Deane J added the further ground that the retention of the executed lease by the company's solicitor and its deliberate silence and inaction had caused the plaintiffs to assume that a building contract existed and to act on that assumption to their detriment. Gaudron J based her concurring judgment on the ground that the defendant was imprudent in failing to inform the owner that it might not proceed with the contract, and thereby caused the owner to act on the assumption that the contract had been executed by it.

To Mason CJ and Wilson J, the issue in the appeal was whether in light of the above facts the appellant defendant was estopped from denying the existence of a binding contract that it would take a lease of

the new building.[75] They rejected the notion that the plaintiffs had been misled into believing that the draft lease had been signed:[76]

> In light of ... the evidence to which we have referred, it would be difficult to sustain a finding that the respondents actually believed that contracts had been exchanged or that a binding contract had come into existence. There was no evidence that the respondents relied on Dawson Waldron's failure to notify amendments on 8 November as indicating that contracts had been exchanged. And, in any event, in the circumstances such a belief, if it existed, could scarcely be a reasonable belief in the absence of inquiry from, and confirmation by, Morton & Harris.

However, the respondents did believe that the signing of the contract was a mere formality:[77]

> The respondents thought that the signing of the agreement, and for that matter exchange, was a formality, something that would occur as a matter of course.... The facts justify the weaker inference drawn by the primary judge that the respondents assumed that the amendments were acceptable to the appellant so that the exchange of contracts was only a formality. This assumption was a reasonable assumption . . .

These findings of fact were significant, because they undercut the availability of common law estoppel to the plaintiffs, as there is a long line of authority holding that to make out a case of common law estoppel by representation, the representation must be one of existing fact.[78] A promise or representation as to future conduct was insufficient to make out such a claim.

If the plaintiffs were to succeed, it would be necessary for them to prove a claim based upon promissory estoppel,[79] however to do so re-

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75 Id 392-93.

76 Id 397.

77 Id 397.

78 Id per Mason CJ and Wilson J at 398.

79 Id per Mason CJ and Wilson J at 399:

> This brings us to the doctrine of promissory estoppel ... Promissory estoppel certainly extends to representations (for promises) as to future conduct.... So far the doctrine has been mainly confined to precluding departure from a representation by a person in a pre-existing contractual relationship that he will

quired a departure from the previous restrictions placed upon the use of this remedy:[80]

> There has been for many years a reluctance to allow promissory estoppel to become a vehicle for the positive enforcement of a representation by a party that he would do something in the future. Promissory estoppel, it has been said, is a defensive equity ... and the traditional notion has been that estoppel could only be relied upon defensively as a shield and not as a sword.... But this does not mean that a plaintiff cannot rely on an estoppel. Even according to traditional orthodoxy, a plaintiff may rely on an estoppel if he has an independent cause of action, where in the words of Denning LJ in *Combe v. Combe*, the estoppel 'may be part of a cause of action, but not a cause of action in itself.' ... But the respondents 'asks' us to drive promissory estoppel one step further by enforcing directly in the absence of a pre-existing relationship of any kind a non-contractual promise on which the representee has relied to his detriment.

Mason CJ and Wilson J noted that to invoke promissory estoppel on the facts of the case would require some departure from the doctrine of consideration. Still, they suggested that equitable relief was possible in appropriate cases:[81]

> One may therefore discern in the cases a common thread which links them together, namely, the principle that equity will come to the relief of a plaintiff who has acted to his detriment on the basis of a basic assumption in relation to which the other party to the transaction has 'played such a part in the adoption of the assumption that it would be unfair or unjust if he were left free to ignore it.' ... Equity comes to the relief of such a plaintiff on the footing that it would be unconscionable conduct on the part of the other party to ignore the assumption.

They went on to conclude that promissory estoppel extends to the enforcement of voluntary promises on the basis that a departure from the

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> not enforce his contractual rights, whether they be pre-existing or rights to be acquired as a result of the representation.... In principle there is certainly no reason why the doctrine should not apply so as to preclude departure by a person from a representation that he will not enforce a contractual right.

80 Id at 400.

81 Id at 404.

basic assumptions underlying a transaction between the parties must be unconscionable.[82] They continued:

> As failure to fulfil a promise does not of itself amount to unconscionable conduct, mere reliance on an executory promise to do something, resulting in the promisee changing his position or suffering detriment, does not bring promissory estoppel into play. Something more would be required.... the United States experience, distilled in the *Restatement* ... suggests that the principle is to be expressed in terms of a reasonable expectation on the part of the promisor that his promise will induce action or forbearance by the promisee ... in circumstances where injustice arising from unconscionable conduct can only be avoided by holding the promisor to his promise.

Mason CJ and Wilson J then attempted to relate the principles which they had extracted from their lengthy review of the law to the facts of the *Waltons Stores* case:[83]

> But the crucial question remains: was the appellant entitled to stand by in silence when it must have known that the respondents were proceeding on the assumption that they had an agreement and that completion of the exchange was a formality? The mere exercise of its legal right not to exchange contracts could not be said to amount to unconscionable conduct on the part of the appellant. But there were two other factors present in the situation which require to be taken into consideration. The first was an element of urgency that pervaded the negotiation of the terms of the proposed lease.... The second factor of importance is that the respondents executed the counterpart deed and it was forwarded to the appellant's solicitor on 11 November. The assumption on which the respondents acted thereafter was that completion of the necessary exchange was a formality.

Ultimately, the true basis for the claim against the defendant was not some notion of promissory estoppel, but rather the breach of a duty. It was not a breach of a duty of care as would support a claim of negligence, but rather a breach of a duty of good faith in contractual negotiations. The breach of good faith was not the representation about its future conduct, but rather its allowing the plaintiffs to form a mistaken

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82 Id at 406.

83 Id at 407.

impression concerning the defendant's present intentions as to its future conduct. Thus Mason CJ and Wilson J, stated:[84]

> It seems to us ... that the appellant was under an obligation to communicate with the respondents within a reasonable time after receiving the executed counterpart deed and certainly when it learnt on 10 December that demolition was proceeding. It had to choose whether to complete the contract or to warn the respondents that it had not yet decided upon the course it would take. It was not entitled simply to retain the counterpart deed executed by the respondents and do nothing.... The appellant's inaction ... constituted clear encouragement or inducement to the respondents to continue to act on the basis of the assumption which they had made. It was unconscionable for it, knowing that the respondents were exposing themselves to detriment by acting on the basis of a false assumption, to adopt a course of inaction which encouraged them in the course they had adopted.

Given this interpretation of the facts, it is somewhat unfortunate that Mason CJ and Wilson J then attempted to 'express the point in the language of promissory estoppel' by holding that the defendant was 'estopped in all circumstances from retreating from its implied promise to complete the contract.'

The decision of Brennan, J took a somewhat different tack. Brennan J apparently believed that in order to fix the defendant with liability it was necessary to show that it had done something inconsistent with the general right of a party to contractual negotiations to walk away from those negotiations. He confronted this issue first by outlining the nature and limits of that general right:[85]

> Parties who are negotiating a contract may proceed in the expectation that the terms will be agreed and a contract made but, so long as both parties recognize that either party is at liberty to withdraw from negotiations at any time before the contract is made, it cannot be unconscionable for one party to do so. Of course, the freedom to withdraw may be fettered or extinguished by agreement but, in the absence of agreement, either party ordinarily retains his freedom to withdraw. It is only if a party induces the other party to believe that he, the former party, is already bound and his freedom to withdraw has gone that it could be

84 Ibid.

85 Id at 423.

> unconscionable for him subsequently to asset that he is legally free to withdraw.

To Brennan J the reason why this was the case was that it was a necessary element of promissory estoppel that the defendant knew or intended that the plaintiffs would adopt or act upon the assumed state of affairs it was creating. Only when that was found to be the case would it be possible to make out the basis of any equitable claim, as the following passage of his judgment makes clear:[86]

> It is essential to the existence of an equity created by estoppel that the party who induces ... [it] ... knows or intend that the party who adopts it will act or abstain from acting in reliance ... When the adoption of an assumption or expectation is induced by the making of a promise, the knowledge or intention that the assumption or expectation will be acted upon may be easily inferred. But if a party encourages another to adhere to an assumption or expectation already formed or acquiesces in the making of an assumption or the entertainment of an expectation when he ought to object to the assumption or expectation–steps which are tantamount to inducing the other to adopt the assumption or expectation–the inference of knowledge or intention that the assumption or expectation will be acted on may be more difficult to draw.

Thus it is very difficult to make out a claim of promissory estoppel where the sole alleged misconduct of the defendant was to remain silent; in order to do so it was necessary to find a duty to speak. Such a duty arises only in a limited range of circumstances:[87]

> Silence will support an equitable estoppel only if it would be inequitable thereafter to assert a legal relationship different from the one which, to the knowledge of the silent party, the other party assumed or expected ... What would make it inequitable to depart from such an assumption or expectation? Knowledge that the assumption or expectation could be fulfilled only by a transfer of the property of the person who stays silent, or a diminution of his rights or an increase in his obligations. A person who knows or intends that the other should conduct his affairs on such an assumption or expectation has two options: to warn the other that he denies the correctness of the assumption or expectation when he knows

86 (1988) 164 CLR 387 at 423.

87 Id at 428.

> that the other may suffer detriment by so conducting his affairs should the assumption or expectation go unfulfilled, or to act so as to avoid any detriment which the other party may suffer in reliance on the assumption or expectation. It is unconscionable to refrain from making the denial and then to leave the other to bear whatever detriment is occasioned by non-fulfillment of the assumption or expectation.

On the basis of this analysis, Brennan J then constructed a general rule governing the availability of promissory estoppel as a cause of action:[88]

> In my opinion, to establish an equitable estoppel, it is necessary for the plaintiff to prove that (I) the plaintiff assumed that a particular legal relationship existed between the plaintiff and the defendant or expected that a particular legal relationship would exist between them, and in the latter case, that the defendant would not be free to withdraw from the expected legal relationship; (2) the defendant had induced the plaintiff to adopt that assumption or expectation; (3) the plaintiff acts or abstains from acting in reliance on the assumption or expectation; (4) the defendant knew or intended him to do so; (5) the plaintiff's action or inaction will occasion detriment if the assumption or expectation is not fulfilled; and (6) the defendant has failed to act to avoid that detriment whether by fulfilling the assumption or expectation or otherwise. For the purposes of the second element, a defendant who has not actively induced the plaintiff to adopt an assumption or expectation will nevertheless be held to have done so if the assumption or expectation can be fulfilled only by a transfer of the defendant's property, a diminution of his rights or an increase in his obligations and he, knowing that the plaintiff's reliance on the assumption or expectation may cause detriment to the plaintiff if it is not fulfilled, fails to deny to the plaintiff the correctness of the assumption or expectation on which the plaintiff is conducting his affairs.

Significantly, Brennan J saw the purpose of promissory estoppel not so much being to enforce the promise as to prevent detriment to the promissee resulting from reasonable reliance on the assumed state of facts which the defendant had caused to be assumed. So it was said:[89]

> The unconscionable conduct which it is the object of equity to prevent is the failure of a party, who has induced the adoption of the assumption or

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88 Id at 428-9.

89 Id at 423.

> expectation and who knew or intended that it would be relied on, to fulfil the assumption or expectation or otherwise to avoid the detriment which that failure would occasion. The object of the equity is not to compel the party bound to fulfil the assumption or expectation; it is to avoid the detriment which, if the assumption or expectation goes unfulfilled, will be suffered by the party who has been induced to act or abstain from acting thereon.

Viewed in this light, the conflict between the doctrines of consideration and promissory estoppel was minimal:[90]

> If this object is kept steadily in mind, the concern that a general application of the principle of equitable estoppel would make non-contractual promises enforceable as contractual promises can be allayed. A non-contractual promise can give rise to an equitable estoppel only when the promissor induces the promissee to assume or expect that the promise is intended to affect their legal relations and he knows or intends that the promissee will act or abstain from acting in reliance on the promise; and when the promissee does so act or abstain from acting and the promissee would suffer detriment by his action or inaction if the promissor were not to fulfil the promise. When these elements are present, equitable estoppel almost wears the appearance of contract, for the action or inaction of the promissee looks like consideration for the promise on which, as the promissor knew or intended, the promissee would act or abstain from acting.

Yet although promissory estoppel has certain quasi-contractual features, Brennan J pointed out a number of important distinctions between the two:[91]

> But there are differences between a contract and an equity created by estoppel. A contractual obligation is created by the agreement of the parties; an equity created by estoppel may be imposed irrespective of any agreement by the party bound. A contractual obligation must be supported by consideration; an equity created by estoppel need not be supported by what is, strictly speaking, consideration. The measure of a contractual obligation depends on the terms of the contract and the circumstances to which it applies; the measure of an equity created by estoppel

90 Id at 423-4.

91 Id at 425.

> varies according to what is necessary to prevent detriment resulting from unconscionable conduct.

It was these distinctions which enabled equitable estoppel to co-exist with the doctrine of consideration; and because of these distinctions, there was no need to limit promissory estoppel so that it served only as a shield and not a sword:[92]

> If the object of the principle were to make a promise binding in equity, the need to preserve the doctrine of consideration would require a limitation to be placed on the remedy. But there is a logical difficulty in limiting the principle so that it applies only to promise to suspend or extinguish existing rights. If a promise by A not to enforce an existing right against B is to confer an equitable right on B to compel fulfilment of the promise, why should B be denied the same protection in similar circumstances if the promise is intended to create in B a new legal right against A? There is no logical distinction to be drawn between a change in legal relationships effected by a promise which extinguishes a right and a change in legal relationships effected by a promise which creates one. Why should an equity ... be regarded as a shield but not a sword?

### *The economics of the Waltons Stores decision*

The main criticism which one would make of the Waltons Stores decision[93] was the failure by the High Court to employ an economic analysis. Had they done so, their decision would have been more sharply focused and more readily applicable to subsequent cases. Because they did not, the decision seems in many respects muddled and poorly structured.

Essentially, the High Court decided the case in favour of the plaintiffs because it saw the defendant's conduct to be unconscionable. The problem is that the court really offered no justification for taking that position. Although the court argued that Waltons Stores had breached a duty owed to the plaintiffs, it offered no real explanation as to why such

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92 Id at 425-6.

93 Given the limited scope of this paper (which is to show how economic analysis may be used to supplement traditional black letter law analysis), it is not necessary to deal with subsequent cases, such as *Commonwealth of Australia v. Verwayen* [1990] 170 CLR 394 and *Foran v. Wight* (1989) 168 CLR 385, which have purported to clarify the application of the doctrine of promissory estoppel.

a duty should be imposed. While the court appealed to and quoted a great deal of case law in support of its decision,[94] the decision which it reached departed significantly from earlier cases and ultimately was policy based. The problem with the decision is not so much the decision that the court reached, but rather that it failed to articulate any clear reason for coming to that decision. Ultimately the court adopted an *ad verecundiam*[95] argument which can be summarized as follows: 'we think the defendant's silence was wrong; we are judges; therefore the silence was wrong.'

Such an approach is manifestly deficient. For a general doctrine of promissory estoppel to play a meaningful role in the negotiation process, it is necessary to isolate and identify the criteria on which it comes into play, rather that to base it on generalized concepts such as unconscionability or unreasonable behavior. Simply proclaiming specific types of conduct to be unacceptable, unreasonable or unconscionable, without explanation as to the underlying rationale for these findings, leaves the doctrine adrift without a rudder. In other words, parties who engage in negotiation must be able to identify specifically the types of conduct which are prohibited not only by reference to anecdotal examples in previously decided case law, but by reference to the type of adverse affect upon the negotiation process which the doctrine is intended to prevent. Unless this is done, there is a substantial risk that the doctrine will have no effect on negotiating behavior, other than to result in the imposition of liability on a largely *ad hoc* basis when individual courts conclude (on criteria never clearly specified) that particular types of dealing are not acceptable in the circumstances. An *ad hoc* approach adds little to understanding and provides no guidance to contracting parties in the future, unless by some coincidence they find themselves in a negotiating situation virtually identical to that of Waltons Stores. It does, however, introduce a significant degree of uncertainty into the bargaining process which (if it does not undermine the formation of

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94 It is not entirely clear that Dixon CJ would have seen the connection between the statements of principle he set down in *Thompson v. Palmer* (1933) 49 CLR 507 and *Gundt v. Great Boulder Proprietary Gold Mines Ltd* (1937) 59 CLR 641, and the doctrine of promissory estoppel as applied in ..., 1965, 'Walton's Stores: Concerning Judicial Method, Jesting Pilot', The Law Book Co., Sydney, 152 at 159-65.

95 An appeal to authority—a form of argument *ad hominem*.

contracts) will certainly result in unnecessary litigation concerning the rights and liabilities of the parties concerned.

In contrast to the general appeal to emotion on which the High Court relied, an economic analysis of the forces at play in the facts underlying the Waltons Stores case would have provided a firm analytical foundation for the decision which the court reached. Under general principles of micro-economic theory, it can be shown that in a perfectly competitive market all resources would be transferred by a process of voluntary exchange to their levels of highest utility. The general requirements of a perfectly competitive economy include the requirement of a perfect contractual environment in which perfect contracts would take shape. We know, of course, that neither the perfectly competitive economy nor perfect contracts that would evolve in that economy exist in the real world. Of particular relevance in the contract formation process is the problem of transaction costs, which was identified by the economist Ronald Coase in the two articles for which he is best known: The Problem of Social Cost and The Nature of the Firm.

### *Contract formation in a perfect contractual environment*

The economic term Pareto-optimality describes a situation in which all resources have been transferred to their highest utility level usages within a market, so that all potential gains from trade have been exhausted. There are two basic premises concerning Pareto-optimality. The first is that among society as a whole economic efficiency is best attained in a perfectly competitive market. The second is that between individuals, voluntary exchanges (bargains) will lead to the transfer of resources from lower to higher levels of utility. As resources are moved to greater levels of utility, aggregate efficiency within society is enhanced.

A perfectly competitive market lends itself to Pareto-optimal results because the features of that market prevent abusive bargaining and unfair contracts. The features of a perfectly competitive environment are: first, a large number of suppliers, with no one or related group of suppliers having a sufficient market share to be able to control prices within or entry into the market; second, homogeneity of product; freedom of entry for new suppliers and for withdrawal from the market by existing suppliers; access to adequate information concerning products and prices among buyers and suppliers in the market; five, an absence of regulatory price control.

Because a perfectly competitive market assumes perfect information, it creates a contractual environment in which all facts relevant to the transaction are known. In such an environment, each party has full information about the nature and consequences of all choices that are open to him or her. Since possession of such information allows the party to gauge the relative change in his or her aggregate level of utility resulting from the adoption of any particular option, in preparing the contract the parties would anticipate and provide for every contingency and allocated all risks arising from or inherent in the transaction between themselves in the most efficient manner possible. Each party would assesses the value of each possible contract term available, rank its relative value, and through a process of negotiation and compromise the parties would ultimately arrive at contractual terms which are ideally suited to their respective goals in the transaction. The price of the contract would fully reflect the risks that each party assumes. Thus any contract produced in such a perfect environment would necessarily be utility maximizing and therefore efficiency enhancing.

Yet even if the environment in which the contract is made is perfect for the contract formation process, the contracts that are produced in those environments will only attain Pareto-optimality if the market in which they evolve is also perfectly competitive. Except in conditions of perfect competition, distortions within the market may become a bar to further trades at a point where some efficiency enhancing bargains as still have not taken place.

Since all perfect contracts (that is contracts created in a perfect contractual environment) would maximize efficiency, it follows that all contracts made under conditions of perfect competition would necessarily promote efficiency. If every contract made under such conditions is enforceable, then the parties may enter into utility enhancing contracts secure in the knowledge that those contracts will be enforced. In fact, under conditions of perfect competition, all contracts must be enforceable: if the law adopts of selective enforcement policy, then it effectively regulates the terms on which contracts can be formed, and so rewrites those contracts which it does not enforce. Such government regulation violates the conditions of perfect competition. Since efficiency cannot be enhanced beyond the equilibrium of a perfectly competitive market, any government regulation within such a market will compromise efficiency to a greater or lesser degree, because it will prevent the at least some contracting parties from structuring their agree-

ment on what they perceive to be the optimal terms. At best the government will match the market, and any failure to match the market will necessarily be less efficient than what the market would naturally evolve in the absence of intervention.

If all contracts under conditions of perfect competition are Pareto-optimal, then there can be no improvement in efficiency as a result of government regulation under such conditions, whether such regulation takes the form of active regulation (e.g. the prescription of contract terms, or the prohibition of certain terms) or passive regulation (e.g. the selective enforcement of the agreed terms of contracts). Where conditions other than those of perfect competition prevail, regulation may improve efficiency, if the effect of regulation is to correct some market deficiency which prevents the attainment of conditions of perfect competition.

The problem, of course, is that conditions of perfect competition do not prevail. All markets deviate somewhat from the assumed conditions of perfect competition, particularly with respect to access to relevant information. These deviations constitute instances of market failure. Under an efficiency model of contract law, one objective of contract law is to correct those market failures which are capable of identification, at least where the costs of such correction are less than the costs to society in allowing the market failure to stand uncorrected. Since the perfectly competitive market will produce the economically optimal results in contractual relations, economic theory tells us that contract law should be structured, so far as possible, in such a way as to mimic the results that would be obtained in negotiation and bargaining in a perfectly competitive market. As transaction costs impose a serious obstacle to the attainment of the desired results of a perfectly competitive market, one objective of contract law would naturally be to reduce transaction costs as much as possible.

In the context of the *Waltons Store* case, the transaction costs with which we are concerned are those related to the negotiation process. In an ideal contractual world, no resources would be committed towards the subject matter of a proposed contract until such time as the contract was concluded. There would, therefore, never be a problem such as that which confronted the High Court in *Waltons Stores.* Unfortunately, the economic realities of the world are such that action upon intended contractual relations cannot always be postponed until the contract is concluded and documented. The uncontradicted evidence of the plaintiffs

was that there was an immediate need to begin work in the *Waltons Stores* case which prevented delay until the receipt of a signed, sealed and delivered lease from the defendants.[96]

In this sort of situation, it is critically necessary for the potential parties to a contract to be able to assume that they will each bargain, if not in good faith, then at least with a degree of honesty. The parties need to be able to assume that they are not being deliberately deceived. Contract law has always protected the parties to a contract against deliberate deception where the contract is made. *Waltons Stores* was an unusual case because the deception took place in the course of negotiation over a contract that ultimately was never made. Essentially, the defendant deceived the plaintiffs in order to reserve the greatest amount of flexibility to itself: it wished to be able to proceed with the contract if it decided to do so with no time or cost prejudice to itself, yet at the same time it wished to reserve the right to walk away even though it knew the plaintiffs were irretrievably binding themselves to the proposed contract.[97]

If we lived in a world of infinite time and patience in which every fact on which a person chooses to rely might feasibly be verified, the principles enunciated in the *Waltons Stores* case would be wrong. In such an environment, a person who chose to act on an assumed state of

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96 per Mason CJ and Wilson J at 394:

> Mr. Elvy pointed out that 'the agreement must be concluded within the next day or two otherwise it will be impossible for Maher to complete it.' Mr. Elvy said that unless agreement was reached Maher would be unable to organize labour and order supplies within the next couple of days before suppliers stopped taking orders and shut down until late January. Mr. Elvy also stated that Maher did not wish to demolish a new brick part of the old building until it was clear there were no problems.

97 Statement of facts at 390:

> On or about 21 November Waltons had second thoughts about proceeding with the lease, and having ascertained from its solicitors that for want of an exchange of parts it was not bound to proceed, instructed them to 'go slow'. On 10 December Waltons became aware that the demolition had commenced. In early January 1984 the Mahers commenced to build in accordance with plans approved by Waltons. On 19 January Dawson Waldron wrote to Morton & Harris saying that Waltons did not intend to proceed with the lease. By then the building was about 40 per cent complete.

facts could be taken to have assumed all risk that those facts were not true, even if some other person might be seen to have in some way induced a belief in their veracity. Since we do not live in such a world, it is necessary to have some alternative rule which recognizes the very high transaction costs entailed in documenting every assumed fact.

In the real world, there is an enormous information gap between the parties to a proposed transaction: neither can be expected to know the subjective intent of the other. Where one party acts so as to create a reasonable impression of its subjective intent, and allows the other to act on the strength of that supposed intent to its detriment, a duty of disclosure is economically necessary. A failure to impose such a duty would undermine the bargaining process by imposing additional (and possibly prohibitive transaction costs of verification), and thereby deter investment (which is contrary to the economic rationale for contract law). With more particular reference to the facts in *Waltons Stores,* it would prevent parties from undertaking reasonable work in expectation of the conclusion of a contract in situations comparable to that which prevailed in *Waltons Stores,* where immediate steps by the plaintiffs were necessary if the contract was to proceed at all.

Thus the result in *Waltons Stores is* not only economically defensible but economically desirable. It is a proper approach because the effect of ruling against the plaintiffs would have been to adopt a rule which would impose unrealistic (i.e. excessively costly and cumbersome) monitoring costs upon persons in a similar position to the plaintiffs. The rule in *Waltons Stores* then is justifiable to the extent that it is intended to reduce the transaction costs associated with the negotiation process. The duty of disclosure imposed upon the defendant is justifiable because there would be no improvement in aggregate economic welfare from allowing a party to negotiate in bad faith in the manner which Waltons Stores did in the transaction leading up that action.

Yet while the result in Waltons Stores is economically justifiable, the reasoning followed by the High Court is justifiable neither doctrinally nor economically. It is not justifiable economically, because it lacks any kind of economic formulation. On a doctrinal level, the decision is not consistent with prior law.[98] Moreover, justifying a rule by

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98 See, for instance, *B.R. Meadows & Sons v. Rockman's General Store Pty Ltd* [1959] VR 68, per Hudson J at p. 70, *NSW Rutile Mining Co. Pty Ltd v. Eagle Metal & Industrial Products Pty Ltd* [1960] SR (NSW) 495 at pp. 509-10; *Combe*

saying that a particular situation is unjust, unfair, unconscionable or unreasonable means nothing. It provides no indication of the problem the that rule is intended to rectify. In contrast, saying that a particular situation undermines the negotiation process by imposing excessive monitoring costs provides a clear definition of the perceived evil and clear guidance as to the type of situation in which the rule is intended to apply. The caution sounded by Trebilcock in the context of inequality of bargaining power is no less applicable in the context of promissory estoppel:[99]

> For a general doctrine such as inequality of bargaining power to be an effective instrument controlling transactional abuses, it needs to be sharp in its focus, conceptually sound and explicit in its policy underpinnings, and operational in terms of both the process of judicial inquiry it envisages and the remedial instruments available to a court to abate objectionable phenomena. A general doctrine bearing on transactional unfairness that cannot meet these criteria will rapidly degenerate, in its applications, into the crassest form of *ad hockery*...

## Conclusion

When we began this inquiry, we posed a simple question: what can economics tell us that black-letter law cannot. In answering this question, let us first consider the parameters of black letter law analysis.

Black letter law analysis evolved within the legal profession because it best meets the need of the legal community to be able to advise as to the legal effect of particular courses of conduct or events. A lawyer must be able to provide his or her client with statement of the client's legal rights, obligations and liabilities. Only rarely is the client interested in what the law ought to be, or how the particular rule of law applicable to the client fits into the overall web of laws governing society. The client's interest is usually limited to very simple questions: do I have to pay; can I sue; am I going to go to jail; how do I get out of this mess.

As the name would suggest, the focus of black letter law is upon wording and facts, rather than upon the purpose and consequences of a

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*v. Combe* [1951] 2 KB 215 (CA) at p. 219; and *Barns v. Queensland National Bank Ltd* (1906) 3 CLR 925 (HC Aust.), per Griffith CJ at p. 938.

99 Trebilcock, M., The Doctrine of Inequality of Bargarining Power: Post-Bentamite Economics in the House of Lords' (1976) 26 *U. Toronto L.J.* 359 at p. 385.

particular rule. In many cases, it is impossible to determine the reason for a law—that is, the goal that it was intended to accomplish. Moreover, judges have limited law making power. One judge cannot rewrite a rule of common law, no matter how ill-advised or out of touch with the times that rule of law may seem to the judge. The power of a judge to shape the law is even more restricted in the case of statute law. Constitutional issues aside, effect must be given to the wording of the statute, irrespective of its effect, even if it can be demonstrated that the statute works entirely contrary to the purpose of the statute as publicly declared at the time of its enactment. In nearly all cases, the judge has to apply the law as he finds it.

The assumption behind black letter law analysis is that general principles of law may be derived from the study of the minute detail of decided cases and the precise wording of statutes, regulations and other codifications of law. The doctrine of *stare decisis* does much to ensure that like cases will be dealt with on a consistent basis. Through the identification and reconciliation of the factors that influenced decisions in previous cases, the lawyer is able to advise the client as to how even a novel case is likely to be decided. To some extent, black letter law analysis can be value neutral: whether one is Marxist, liberal or conservative, one should still be able to determine the law through such an analysis.

There are problems, however, with black letter law analysis. First, no two cases are exactly alike, and quite often there may be some uncertainty as to which of two or more statutory or common law rules govern a particular situation, or indeed, it may even be uncertain as to whether any existing rule applies to that situation at all. In other words, quite often it is necessary to chose among competing authorities: does rule 'A' apply, or rule 'B'. When this question presents itself, the lawyer (and ultimately the judge or other adjudicator before whom the case must come) must decide which authority shall govern the situation, and to decide that, the lawyer or adjudicator must have some reason for making that selection.

In such cases, the value neutrality of black letter law is misleading. Instead of being value neutral, the judge's analysis will be heavily influenced by the judge's conception of justice—that is, by the judge's value choice as to the rule that should apply. Quite often, the judge will have an idea of an overall goal that the law should promote, but this overall goal will not be articulated. Instead, the judge will advance a proposed

rule as the one to govern a situation, without any explanation as to why it is more appropriate than any other rule. Such an approach provides no method for testing whether the judge is correct in his or her assertion. In other words: why is one rule of law better than another rule of law. Furthermore, if the development of the law is not channelled towards identified goals, it becomes difficult to decide whether the goals pursued under various related rules of law are consistent, or whether those goals would be more easily attained under some competing rule of law.

Second, black letter law works fine so long as the rules of law are clearly stated, along with the reasons for their application to particular facts. It breaks down where the factors that have influenced decisions or other rules of law are confused, poorly identified or badly prioritized. Once again, in such cases, it is necessary to analyze the application of a particular rule on the basis of what rule ought to apply. Thus once again value neutrality is compromised.

Third, black letter law tends to be a very technical and detailed method of analysis. Quite often it is impossible to derive general principles by focusing on the wording of statutes and case law, rather than on the reconciliation of the purpose of the law and the effect of decisions. For this reason, black letter legal analysis can sometimes resemble a game of trivial pursuit, in which the lawyer or judge states a host of specific rules, in the hope that future cases can be decided in some manner that is consistent with such rules.

Consistency alone provides little guidance for the future development of the law. Quite possibly, rules which have been long applied may be badly conceived, at least in the context of the modern age. The fact that a particular case is out of step with earlier decided or higher decided cases does not mean that it is improperly decided, in the sense that the rule which it sets out may better promote human welfare (however that may be defined) than the rule embodied in the earlier or higher authority. Moreover, as noted above, in areas where it is unclear which rule governs, there must be some standard of reference for deciding which rule to apply.

Economic analysis fits into the scheme of legal reasoning not as a substitute for black letter law research and analysis but as a complement to it. It assumes that rules of law very often have particular economic purposes, and that even if they do not, they very often if not always have economic effects. They create entitlements and impose obligations and thereby confer revenue and exact cost.

Beyond doubt, the High Court had a definite intent to grant an entitlement and impose obligations in *Waltons Stores.* Unfortunately, they did not do a very good job of articulating the specific goal that they intended to achieve or their reasons for believing that it was necessary to achieve that goal. Had the court concentrated more clearly on the economic forces that were at work in *Waltons Stores,* than it did on appeals to abstract principles of justice, their decision would have been straight to the point. Their rule might have been formulated in a way that was both economically and doctrinally sound, and on terms sufficiently precise to give clear guidance to its future application. Said, this opportunity was missed.

Economic analysis is of use in predicting the ultimate economic effect of particular right allocations.[100] One important role for economics is in influencing policy direction. It is important for legislators and courts to know, for instance, that the allocations of rights to one person may result in that person being cross-subsidized by others. Cost/benefit analysis is also highly relevant to the legislative process. While economic analysis is of most use in the legislative field, where the legislature has (at least in theory) almost unlimited policy discretion, it may also be of use in the judicial and administrative realm, where the decision maker has some element of discretion as to the where to assign rights and obligations and the terms in which to define those rights and obligations. Here one harkens back to the words of Ronald Coase in 'The Problem of Social Cost':[101]

> ... whatever we may have in mind as our ideal world, it is clear that we have not yet discovered how to get to it from where we are. A better ap-

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100 Thus Edmund W. Kitch wrote in 'The Intellectual Foundations of "Law and Economics"' (1983) 33 *J. Leg. Ed.* 184 at p. 184:

> The principal intellectual foundation of 'law and economics' has been its relative success in illuminating two fundamental questions: First, what effects do legal rules have upon society? And second, how do social forces shape and determine the law? Law and economics has enjoyed relatively greater success in addressing these questions in a provocative and illuminating manner than have other approaches to the study of the phenomenon of law.

101 (1960) 3 *J. Law and Econ.* at 43; reprinted in W. Breit, H.M. Hochman (eds), *Readings in Microeconomics,* 2nd edn, Holt, Rinehart and Winston, New York, 484 at 517.

> proach would seem to be to start our analysis with a situation approximating that which actually exists, to examine the effects of a proposed policy change and to attempt to decide whether the new situation would be, in total, better or worse than the original one. In this way, conclusions for policy would have some relevance to the actual situation.

But an equally important role for economic analysis is what it teaches us concerning the probable outcomes of policy alternatives, irrespective of the basis on which they may be grounded.

In this respect, the economic analysis of law teaches us a great deal about the limits of law as a tool of social policy. For instance, the Coase Theorem leads us to the conclusion that the assignment of entitlement will often be only the first step in a longer process of exchange. By following that process of exchange through to its logical conclusion, it is possible to determine whether there is a high or low probability of attaining the policy objectives which underlie the assignment of the original assignment of entitlement. In this way, economic analysis can explain why so many laws have been less than successful as, for instance by showing on the basis of rather elementary price theory and economic data, why so many supposedly balanced or scientific regulatory regimes have resulted in social loss, protected and politically powerful industry groups, and a generally inefficient level of operation.[102]

Thus the economic analysis of law can help provide answers which rectify the short-comings of black letter law analysis alone. Unlike black letter law, economic analysis is more policy oriented. The standard of economic efficiency does provide one clear basis which can be employed as a touchstone in policy formation. But that in itself is not the justification for the use of economic analysis. Rather, the strength of economic analysis is that it provides insight into the effect of legal policy choices, irrespective of the basis on which those choices are made. In deciding, for instance, whether to award damages or an injunction to farmers whose crops were damaged by fires caused by sparks emitted from passing steam engines, or to allow the train to continue operations as a reasonable use of the railroad property, economic analysis can illuminate many of the subtler issues inherent in either selection (the need to encourage reasonable accident avoidance steps by injured par-

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102 E. Kitch, 'The Intellectual Foundations of "Law and Economics"' (1983) 33 *J. Legal Educ.* 184 at193.

ties, the transaction costs which constitute obstacles to market solutions, the effect of cross-subsidization from one industry to another) inherent in each solution which a court may consider. In deciding whether to award the entitlement, the court need not be guided by economic efficiency criteria alone-the maximization of social output-in order to gain benefit from understanding these aspects of the decision.

Nevertheless, the use of economic analysis in the study of law has limitations in much the same way that the use of black letter analysis has limitations. While black letter law tends away from value judgment, the economic analysis of law can be heavily value laden, particularly where the maximization of social product is advanced (implicitly or explicitly) as the sole criteria which should influence the direction of the law. In placing so much emphasis on economic efficiency and economic consequences, economic analysis may ignore equally important social costs of competing right and resource allocations. Put simply, economic efficiency is only one factor to consider in deciding whether a proposed law promotes justice.

Yet acknowledging that economic efficiency may not be determinative of whether a particular rule is just, it is surely a relevant consideration. At the very least, economic analysis provides some insight into normative questions and policy making-the economic consequences and objective are relevant to the law, particularly during the policy formation stage. In torts, property, corporations law, securities law, banking law, partnership law, tax law, environmental law, contract law, trade practices and consumer protection, the economic costs of law are all important. It is important to know who benefits when laws are structured in a particular way. It is equally important to know what costs are imposed upon the system by those laws, and who must pay those costs. It is not enough in enacting law to have a laudable goal. There must be reason to believe that the law in question will further the attainment of that goal: we must have reason to believe that the rules of law imposed will achieve the desired end.

Chief Justice Mason's critique of economic analysis seems to be based on a faulty premise. He assumes that economic analysis precludes the use of traditional legal scholarship. Far from it: there is no reason why economic analysis cannot be combined with black letter law analysis. A black letter law review of the law provides a comprehensive picture of a field of law. However, economic analysis allows the lawyer to go further. It permits the lawyer to fill in gaps within the law through

the application of consistent criteria. It provides a clear measure of whether rules of law are consistent in objective and effect. It allows the lawyer to determine whether cases are distinguishable or are sufficiently similar in economic terms that the same rules should apply to them.[103] Thus economic analysis can add weight to the lawyer's submissions and judge's conclusions concerning what the law 'ought to be'.

In conclusion, courts and legislatures must confront the fact that the rules of law which they set down have economic effects. It is one thing to argue that economic efficiency should not necessarily be determinative of legal issues. It is quite another to argue that the economic effects and implications of particular resolutions of legal issues should be ignored. Economic costs are not the subject of fantasy. They are costs that ultimately must be paid. In an increasingly competitive world, it is not enough for courts or legislatures to adopt new rules of law and simply hope for the best.

No doubt there are situations in which economic efficiency must take a back seat to some other social value. However, while some people may support allocations of rights and obligations (and restrictions upon freedom) that do not promote economic efficiency, it is not unreasonable to insist that the economic consequences that flow from such allocations be considered., and to insist than uneconomic results be justified on clearly defined criteria. Surely the cost implicit in any allocation of rights and obligations is an important consideration. Where economic modelling and analysis will permit courts to formulate and state rules of law in clear terms, and to expound upon the underlying reasons for their decisions, it is obviously better that they do so than for them to reduce their decisions to little more than rambling discourses on the *ratio descidendi* of some long forgotten cases.

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103 Harry Hansmann, 'The Current Sate of Law and Economic Scholarship' (1983) 33 *J. Legal Ed.* 217 at 226. For an illustration of where such a systematic approach has been adopted in the context of the law of mistake, see Kronman, A.T., 'Mistake, Disclosure and the Law of Contracts' (1978) 7 *J. Leg. St.* 1.