

RESPONSE TO JAMES GORDLEY'S "GOOD FAITH IN CONTRACT LAW: The Problem of Profit Maximization"

By

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We have been given a wonderful example by Professor Gordley of a cogent, yet straightforward and simple explanation of the value of natural law principles in understanding and applying legal doctrine.

Before the advent of the modern era legal, political and moral philosophers accepted the notion that law and morality are intertwined and that law is both an agency of social control and an expression of morals. The debate among adherents of Natural law and adherents of Legal Positivism over the relationship between law and morality has been a central theme of modern jurisprudence. What Professor Gordley has shown by his numerous carefully chosen examples is that an understanding of modern legal systems requires an appreciation that in the process of interpreting legal rules and deciding cases courts recognize the limits of rules and, in fact, resort to broad principles of equity and justice which embody moral standards. He has deftly illustrated how the broad equitable principle of the obligation of good faith in contract law has been invoked in many legal systems to deny enforcement to contracts where the price term is far below or above the market price or what Thomistic philosophers would describe as a just price.

Professor Gordley has identified the crux of the difference between the view of modern economists, who have evolved from Adam Smith, and the Thomistic point of view regarding the institution of contracts and the concepts of a market price and a just price. He asserts that Adam Smith and later economists emphasize that self interest justifies the pursuit of profit and that benefit to society is merely an indirect by-product of self interest. Thomistic philosophy, however, connects self interest in the pursuit of profit with the benefit conferred upon another and the requirements of commutative justice.

Although St. Thomas Aquinas and later Thomists use different terminology, they essentially define market price in the same way that Adam Smith and modern economists have--as the product of the forces of supply and demand. But while economists eschew moral value judgments in their analysis of economic activity and offer no opinion about the criteria for a just price, St. Thomas, as a moral theologian, understandably provides an evaluation of profits from a moral point of view. He concludes that profit must be evaluated in terms of the criteria of commutative justice and the common good. From the Thomistic natural law perspective, the market price is considered the just price. Thus,

one who profits from selling beyond a just price or profits from buying at a price below the market price commits a commutative injustice.

Economists view profits solely in terms of a legitimate expression of self interest which ultimately, though indirectly, benefits society by adding value to goods and services. Therefore, from the point of view of economic theory, the greater the profits, the greater the benefit to society. This reflects a distinct form of rationality, i.e. economic rationality or rationality consisting of a cost benefit analysis. Moral philosophers in the Thomistic tradition, however, employ a distinctly different kind of rationality. They employ value rationality which entails discerning the values or ends reflected in human actions and a consideration of the relationship between values or ends and the means to achieve them. A third kind of rationality, instrumental rationality, is exclusively concerned with the means to achieve given ends. Value rationality is broader than and encompasses both economic and instrumental rationality. This value orientation and focus on means-ends relationships is an essential element of natural law thinking. Economic analysis of law is much more restricted. It is premised on the assumption that law is a means of achieving wealth maximization and efficiency which translates into an emphasis on protection of property rights and freedom of contract, often at the expense of or indifference to justice.

Professor Gordley has skillfully avoided the liabilities of concentrating on the realm of philosophical opposites and doctrinal debates, by examining the problem of profit maximization from a practical starting point: how modern legal system actually function in relation to the economic world, i.e. what is the law? He asks whether the response of courts in modern legal systems in deciding contract cases reflects the Thomistic conception of the market price as the just price rather than the modern economists conception of market price as merely the product of self interest.

Professor Gordley has shown by his numerous carefully chosen examples that courts in modern legal systems, through the process of interpreting legal rules and deciding cases, recognize the limits of rules and resort to broad principles of equity and commutative justice in deciding contract cases.

Although he invokes the natural law philosophy of St. Thomas Aquinas, he never uses the term natural law. The mere mention of natural law conjures up various negative images and objections. I am reminded of Jeremy Bentham's comment that natural law is "nonsense on stilts." For many natural law represents little more than disguised religion because historically the Catholic Church has been among its major defenders and proponents. Critics of natural law are wont to describe it in negative terms as a distorted idea of law without basis in fact. For example, a favorite tactic is to point to Thomas Aquinas' statement that "unjust law is not law" and then to assert that this position is obviously absurd because quite clearly unjust laws do exist in every legal system. Thus, the aim is to discredit the concept of natural law as contrary to common sense and inadequate to explain and describe the nature of law and legal systems. Of course, this statement of St. Thomas is taken completely out of context. Neither St. Thomas himself nor any other natural law philosopher would deny the existence of unjust laws. They

would simply assert that legally valid or legally binding unjust laws are not binding in conscience, i.e. morally obligatory.

Contemporary natural law theories, in particular the theories of John Finnis and Ronald Dworkin, readily accept that the legal validity of a legal rule depends only upon its existence as part of legal system and not upon whether it is consistent with the requirements of justice. Indeed, both Finnis and Dworkin would accept as the focal meaning of law the narrow Positivist definition of law as a system of existing legal rules made by political superiors for political subordinates. Finnis and Dworkin and other contemporary natural law theorists conceive of natural law as essentially a moral theory and argue that natural law principles or the principles of practical reason, are necessary to critique and evaluate existing law and to provide a basis for interpreting and applying the law so as to achieve the goals of justice and the common good.

The presentation we just heard meets head on a major criticism of natural law theory, i.e. the so-called illicit inference from the is to the ought or from fact to value. Professor Gordley has presented examples from diverse legal systems demonstrating that the law is, in fact, value laden and that legal decisions are, in fact, based on moral standards. In case after case he shows how the equitable principle of good faith, or other equitable principles akin to it, such as the doctrine of unconscionability, duress, undue influence or fraud, have been invoked to deny enforcement to unfair or unjust contracts. He argues persuasively that the Thomistic view of profit as the reward for conferring a benefit upon another and justified only when the exchange is consistent with the requirements of commutative justice provides a much better explanation for how courts in modern legal systems decide contract cases than the more limited understanding of profit of Adam Smith and modern economist that profit is simply a legitimate pursuit of self interest which indirectly benefits society.

While I agree with most of what Professor Gordley has said I take issue with his assertion that Adam Smith's conception of a market price and the pursuit of self interest was unrestrained by the requirements of commutative justice. Just like St. Thomas, Smith's views are often distorted and taken out of context. It is important to remember that Adam Smith was a moral philosopher who wrote *The Theory of Moral Sentiments* before his more famous *The Wealth of Nations*. His treatment of "justice" in *The Theory of Moral Sentiments* is especially important for a proper interpretation of *The Wealth of Nations*. Smith always used the word justice to mean substantially what Aristotle and the Schoolmen meant by "commutative justice." Justice is a negative virtue: it consists of refraining from injury to another person by taking or withholding from another what belongs to him. For Smith, the natural or spontaneous sentiment of justice is not, however, strong enough in ordinary men to meet the needs of society. Consequently, he

believed that men have been endowed with the propensity to formulate rules of justice on the basis of their experience and reason, and that the chief function of government is to enforce justice on individual members of the community through law and the magistrates.

In *The Theory of Moral Sentiments*, Smith minimized the contribution of the pursuit of wealth to the happiness of the individual. Although he considered the increase in the aggregate wealth as a highly worthy objective, he attached little significance to increase above a quite modest level of per capita income. He saw great value in the increase in aggregate wealth to support aesthetic and intellectual culture and of civilization in general, which he associated with communal enrichment. Smith understood the concept of the common good as the conditions necessary for human flourishing.

Adam Smith believed that the basic source of economic progress was the striving of individuals in pursuit of self interest and that the desire to improve one's economic status and condition "comes with us from the womb and never leaves us till we go into the grave." He did not believe that this desire to pursue self interest does or should operate without restraint. He held that self interest must be disciplined by the sentiment of justice and by government enforcement of justice.

Adam Smith had a normative approach to economic theory. The separation of normative and non-normative, or policy, economics is a fairly recent phenomena. Even today it is hard to maintain that separation, because many of the standard terms used in economic analysis carry with them a normative or evaluative connotation: for example "utility", "value," "productive," "equilibrium." In Adam Smith's normative approach to economics, he was as emphatic as he could be on the vital need for government enforcement of justice. Indeed, in *The Wealth of Nations* there is evidence that he not only would have included in the function of government the formulation of rules of justice and machinery for the punishment of their infraction, but the enactment of requirements to prevent injustice such as standardization of weights and measures, requirements that goods offered for sale be so stamped as to indicate their quality, and the establishment of building standards that would hinder individuals from subjecting others to the risks of fire or other hazards to their property and personal safety. In view of his emphasis on the restraint of self interest by the requirements of commutative justice, Adam Smith's normative economics, absent distortions and exaggerations, may have more in common with Thomistic philosophy than modern day economics.

Natural law theory finds expression in equity jurisprudence which historically has infused morality or moral standards into the law. Aristotle's conception of natural law is based on the model of equity, which he defined as natural justice. In Book V. of the *Nicomachean Ethics*, Aristotle defined equity as "a rectification of law that is deficient by reason of its universality." Natural law theories, despite significant differences, have as a common thread the emphasis on the relationship between law and morality, the notion that reason is the measure of human conduct, and that the purpose and function of law is the attainment of justice and the common good. There is a current revival of interest in natural law evidenced by the response by scholars to John Rawls', *A Theory of Justice* (Belnap Press of Harvard Univ. Press 1971), John Finnis' *Natural Law and Natural Rights*

(Oxford Press 1980) and Ronald Dworkin's, *Law's Empire* (Belnap Press of Harvard Univ. Press 1986) which, albeit in different ways, point out the limitations of narrower philosophies that fail to take sufficient account of the relationship between law, reason, and justice. Although those of us who are drawn to the tradition of reason that has its roots in the thought of Aristotle and Aquinas can take comfort in this latest revival of the concept of natural law, we should take pains to seek a proper understanding of natural law while avoiding exaggerated claims about its explanatory power.

Professor Gordley has utilized concrete and specific aspects of a particular natural law theory to evaluate and explain legal doctrine. In doing so, he has avoided the potential confusion and emotional reaction that sometimes follow when the term natural law is invoked. We would do well to follow his example. Rather than refer to the concept of natural law it is better to apply a particular conception of natural law in the analysis of concrete problems while incorporating the insights to be gained from alternative conceptions of law. Although he has adopted a Thomistic natural law perspective, Prof. Gordley's method of analysis might meet with the approval of legal positivists and legal realists, who emphasize a descriptive analysis of law, because he has carefully focused attention on the law as it is. At the same time, he has demonstrated how contract law is not value free but clearly an expression of justice and thus consistent with notions of what law ought to be. His analysis reveals how contract law fosters the values of justice and fairness as much as the values of autonomy and efficiency, which tend to be the exclusive focus of economists despite their assertion of value free inquiry. The cases he analyses in which the obligation of good faith or other equitable principles are invoked in refusing to enforce unjust contracts exemplify a central tenet of Thomistic and other natural law theories that law is an expression of justice and that justice matters.