ABSTRACT:

The legal rules of contracts and corporations can be divided into two distinct classes. The larger class consists of “default” rules that parties can contract around by prior agreement, while the smaller, but important, class consists of “immutable” rules that parties cannot change by contractual agreement. Default rules fill the gaps in incomplete contracts; they govern unless the parties contract around them. Immutable rules cannot be contracted around; they govern even if the parties attempt to contract around them. For example, under the Uniform Commercial Code (U.C.C.) the duty to act in good faith is an immutable part of any contract, while the warranty of merchantability is simply a default rule that parties can waive by agreement. Similarly, most corporate statutes require that stockholders elect directors annually but allow the articles of incorporation to contract around the default rule of straight voting. Statutory language such as “[u]nless otherwise provided in the certificate of incorporation” or “[u]nless otherwise unambiguously indicated” makes it easy to identify statutory default, but common-law precedents can also be divided into the default and immutable camps. For example, the common-law holding of Peevyhouse v. Garland Coal & Mining Co.

, which limited damages to diminution in value, could be contractually reversed by prospective parties. In contrast, the common law prerequisite of consideration is largely an immutable rule that parties cannot contractually abrogate.

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Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules

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