

DISTINGUISHED GAMBLERS: THE STRUGGLE TO SEPARATE SPECULATION AND INSURANCE  
FROM GAMBLING

The idea of wager or even of gambling presents a paradox for contract law. A basic tenet of common law contract doctrine is that contracts to wager are unenforceable, since they are deemed contracts in contravention of public policy.<sup>1</sup> On the other hand, contract “is the projection of exchange into the future,”<sup>2</sup> and as the future is always uncertain, contracts are often acknowledged as a mechanism of allocating risk.<sup>3</sup> Juxtaposing these two commonplaces, the question becomes, how do we distinguish allocation of risk (legitimate and central to contract), from gambling or wagering (illegitimate and outside of contract)? This question becomes particularly acute in those cases where contracts allocate risk statistically (especially insurance contracts) or where contracts seem disconnected from any underlying business logic (in speculative trading of commodities futures). The problem for contract law with transactions like these is that they look like regular, legitimate contracts, but at the same time, they look like gambling.

These following chapters analyze that paradox by concentrating on a developmental stage of the legal treatment of transactions whose primary object is risk. The cases examined turn on the validity of commodities trading contracts and insurance contracts around the turn of the century. Like any good historical story, this is more than one tale. The history presented here offers a counter narrative to a familiar conception of contract as coming to terms with a growing uncertainty that accompanied industrial concentration.<sup>4</sup> It combines historical investigation into seemingly narrow doctrines of contract law with questions regarding the place of uncertainty in a changing culture, suggesting that current and popular views of the topic miss the mark. It adds to the mix questions of how policy inflects legal decision making, and looks at judicial rhetoric as part of a process of defining or constructing modern individuality. Telegraphically put, the chapters in this part make two interrelated claims: first, the problem of wager, generally considered a marginal aspect

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<sup>1</sup> See 3 Samuel Williston, *The Law of Contracts* § 1664, § 1668 (1<sup>st</sup> ed. 1920). In addition to common law unenforceability, almost all states have anti-gambling statutes, covering particular forms of gambling, and creating exemptions for state-sponsored gambling and for activities regulated by the state that might otherwise be considered gambling (the most obvious examples are state lotteries and, where applicable, casinos; the most important example is state and federal regulation of commodities futures trading and of insurance).

<sup>2</sup> Ian Macneil, “The Many Futures of Contracts,” 47 *S. Cal. L. Rev.* 691, 712-13 (1974).

<sup>3</sup> See *Spartech Corp. v. Oppen*, 890 F.2d 949, 955 (7<sup>th</sup> Cir. 1989) (“A principal purpose of contracts is to allocate the risk of the unexpected in accordance with the parties’ respective preference for or aversion to risk and their ability or inability to prevent the risk from materializing...”) See also Anthony Kronman & Richard Posner, *The Economics of Contract Law* 4 (1979).

<sup>4</sup> This view is a staple of mainstream thinking about contract. Robert A. Hillman, *The Richness of Contract Law: An Analysis and Critique of Contemporary Theories of Contract Law* 173-90 (1997); Lester G. Lindley, *Contract, Economic Change, and the Search for Order in Industrializing America* 281-86 (1993); Kevin M. Teeven, *A History of the Anglo-American Common Law of Contract* 236-40 (1990).

of contract, ought to be seen as central to the development of modern contract law; and second, the emergence of a thoroughly modern law of contract and the associated legal treatment of wagers are fruitfully engaged as an important part of the process of constructing our current notion of individuality, with its attendant market consciousness.

The focus on turn-of-the-century cases should not lull the reader into a false sense of security regarding the question of distinguishing between contract and gambling. While the historical view serves to concentrate attention on a period in which societal attitudes toward risk underwent a transformation, we should not assume that modern contract law is free from ambiguity on the topic. Rather, the same inability sharply to distinguish gambling from the “legitimate” and “productive” sectors of the economy is replayed today, only at a faster pace and with larger stakes. Heated debates over the regulation of the rapidly growing market in derivatives and over the emerging industry of viatical settlements are modern examples of the same difficulties analyzed here historically.

Labeling transactions as wagers is one way to limit freedom of contract. The underlying question always revolves around the extent to which the state will support or restrict the attempts of individuals or groups to undertake obligations. Today, it is more common to frame the debate over the legitimacy of risk as one over the scope of state regulation generally. In contrast, around the turn of the last century, the question of wager was one of the key doctrinal areas defining the scope of freedom of contract. The parallels between these issues should emerge as the discussion proceeds. I do not set out to answer the question of how much regulation of contracting behavior is appropriate. The more modest goal here is to suggest that one basic puzzle about contract regulation, that of distinguishing legitimate from illegitimate risk, while often taken for granted as definitively settled, is actually a problem for which no satisfying solution has been offered, much less adopted.

This part comprises four chapters. The present chapter offers a brief historical sketch of the connections among gambling, speculation, and insurance, and the attempts through the nineteenth century to distinguish these practices. Chapters six and seven put on display a somewhat old-fashioned exercise in reading cases, providing a detailed analysis of the development of the law surrounding commodities futures trading and life insurance contracts, with heightened attention to the policy analysis carried out by judges adjudicating disputes that arose in these areas.<sup>5</sup> The point of the analysis is not only to unravel the legal doctrine, but more importantly, to examine the rhetorical maneuvers

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<sup>5</sup> The reading of the cases proceeds on the basis of Legal Realist insights, comparing similar cases with different outcomes whose results cannot be reconciled on the basis of legal argumentation. Oliver Wendell Holmes, Jr. and the Realists who followed his example believed that these decisions were based on “policy” or what they sometimes called legislative considerations. Critical legal scholars have noted that “policy” is a vehicle for ideology. This book employs a yet more expansive notion of policy, including a cultural politics. The founding instance of this mode of critique is Oliver Wendell Holmes, Jr., “Privilege, Malice, and Intent,” 8 *Harv. L. Rev.* 1 (1894); an example of its developed Realist form is, Walter Wheeler Cook, “The Present Status of the “Lack of Mutuality” Rule,” 36 *Yale L.J.* 897 (1927). The strategy, and the role of the Critical Legal Studies movement in explaining policy as ideology, is described in Duncan Kennedy, *A Critique of Adjudication: Fin de Siecle* 82-100 (1997).

through which judges justified their decisions. Through this analysis, I explore judicial rhetoric as the site of a cultural conflict whose intensity reached a peak around the turn of the century. Finally, chapter eight is an interpretation of turn of the century policy bases of the decisions, and a comment on the place of uncertainty in legal rhetoric around the turn of the century. It argues that rather than neutralizing objective uncertainty by developing doctrinal tools,<sup>6</sup> contract law is part of a richer and more complex story of Americans' love/hate relationship with risk.

Up until early in the nineteenth century, insurance on the one hand, and stock and commodities trading, on the other, were viewed as indistinguishable or at least very difficult to distinguish from gambling. Establishing a distinction was more than a legal question, in that it was crucially intertwined with a vision of society, and with a vision of what the individual must be in order to make up society, or to be fit for society. In other words, the distinction between gambling and its cousins in the realm of legitimate speculation is part of a process of socializing individuals. This is meant to be a term with double meaning: on the one hand, it is a process that acts on concrete individuals, by imposing a view of normative behavior; but on the other hand, it is a process of creating individuals, where initially a concept of individuality may have been far less important.<sup>7</sup> The example of insurance is illuminating here: whereas in a more localized economic and social environment, loss was dealt with communally, for example, by extended family or neighbors caring for the families of the deceased or disabled, the rise in urbanization and mobility makes individually procured insurance the key mechanism in providing for loss, breaking the ties that cement communal feeling. Insurance thus substitutes a faceless collective for a familiar communal collective.<sup>8</sup>

Historians have told the story of gambling and anti-gambling in the nineteenth century along several lines, some of them including important race and class distinctions in the treatment of gambling. The insight I want to link onto here, however, is that an important element of the anti-gambling movements, and even of incidental anti-gambling rhetoric, was an attempt to legitimate a certain view of human activity that revolved around gain. In other words, part of the function of anti-gambling discourse was to construct acquisitive individuality (including the possibility of speculation) as the normative form of human subjectivity. This may sound paradoxical at first, since who after all, is more interested in gain than the gambler? This should become clearer as we proceed.

To begin to understand the opposition to insurance and to speculation, one must look to the reigning morality and especially the religious world view that was dominant in the United States until late in the nineteenth century. Describing the change that occurred

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<sup>6</sup> See Walter F. Pratt, Jr., "American Contract Law at the Turn of the Century," 39 *S.C. L. Rev.* 415 (1988).

<sup>7</sup> Ian Hacking terms this process "making up people." See generally Ian Hacking, *The Taming of Chance* (1990).

<sup>8</sup> Reuven Brenner & Gabrielle A. Brenner, *Gambling and Speculation: A Theory, a History, and a Future of Some Human Decisions* 106 (1990).

through the nineteenth century, Ian Hacking has written, “In 1800 the world was deemed to be governed by stern necessity and universal laws. Shortly after 1930 it became virtually certain that at bottom our world is run at best by laws of chance.”<sup>9</sup> From its inception in the seventeenth century and well beyond, the notion of probability was linked with gambling devices like dice and lotteries, and the mathematicians who developed probability theory initially did so at the behest of professional gamblers.<sup>10</sup> What eventually developed into the actuarial conception of risk was a notion of probability explicitly linked with gambling, and this, in part, explains why “insurance and gambling were at first classified under the same heading.”<sup>11</sup> An additional reason insurance was seen as gambling was that early insurance schemes were, in fact, “outright bets on human lives.”<sup>12</sup> In England, the link between insurance and gambling was especially strong, and it was common for people to “insure” against the death of public personalities such as the king or members of the cabinet, with whom they had no personal relationship.<sup>13</sup>

One example of a type of insurance betting is the tontine policy, or what in American insurance parlance was known as the deferred dividend policy: this was a type of annuity shared by subscribers to a loan, with the shares increasing as subscribers died, till the last subscriber got all that was left. In other words, a number of individuals would invest money into a pool, adding to its size in the first years by paying premiums; after five (or in some cases ten) years, dividends begin to be awarded, which grow larger as members of the group die off; each participant then, is betting on the short life of his fellows, or at least on his own life being the longest.<sup>14</sup>

Insurance was a suspicious concept. It was widely claimed and accepted, for instance, that insurance was an attempt to interfere with Divine Providence. As sociologist Viviana Zelizer has recounted in detail, life insurance was viewed as immoral and sacrilegious, its benefits derided as dirty money. Critics objected that an agreement whereby one party profited from the death of a loved one was “a speculation repugnant to the law of God and

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<sup>9</sup> Ian Hacking, “Was There a Probabilistic Revolution 1800-1930?” in 1 *The Probabilistic Revolution* 45 (Lorenz Kruger et. al., eds., 1987).

<sup>10</sup> Tom Baker, “On the Genealogy of Moral Hazard,” 75 *Texas L. Rev.* 237, 246 (1996); Ian Hacking, *The Emergence of Probability* (1975).

<sup>11</sup> Brenner & Brenner, *Gambling and Speculation*, 104.

<sup>12</sup> Viviana A. Rotman Zelizer, *Morals and Markets: The Development of Life Insurance in the United States* 69 (1979).

<sup>13</sup> Lorraine J. Daston, “The Domestication of Risk: Mathematical Probability and Insurance 1650-1830,” in 1 *The Probabilistic Revolution*, 237, 244.

<sup>14</sup> See Morton Keller, *The Life Insurance Enterprise, 1885-1910*, pp. 56-58 (1963); Brenner & Brenner, *Gambling and Speculation*, 104. Interestingly, despite their analytic similarity to gambling, tontine policies were not initially targeted as wager contracts in the U.S., where insurable interest doctrine ignored, to some extent, the form of the policy itself: “There is no doubt that a man may effect an insurance on his own life for the benefit of a relative or friend; or two or more persons, on their joint lives, for the benefit of the survivor or survivors. The old tontines were based substantially on this principle, and their validity has never been called into question.” *Connecticut Mutual Life Ins. Co. v. Schaefer*, 94 U.S. 457, 460 (1876).

man.” Religion was the most prominent source of cultural opposition to life insurance, and early nineteenth-century religious leaders portrayed insuring against death a bet against God as well as a usurpation of the functions of divine providence.<sup>15</sup>

Even more intensely than insurance, various types of financial speculation, whether regarding the value of land, stocks, or agricultural commodities, were often associated with gambling. Critics of speculation railed against the prevalence of commercial gambling:

If, instead of betting on something so small as falling dice, one bets on the rise and fall of stocks or on the price which wheat will reach some months hence, and if by such betting one corners the community in an article essential to its welfare, throwing a continent into confusion, the law will pay not the slightest attention. A gambling house for these larger purposes may be built conspicuously in any city, the sign ‘Stock Exchange’ be set over its door, influential men appointed its officers, and the law will protect it and them as it does the churches.<sup>16</sup>

Populist movements in the agricultural states agitated for legislation to eliminate speculation in futures, using metaphors of diabolical gambling to describe speculators.<sup>17</sup> Speculators countered, in books, popular publications, and arguments before legislators, emphasizing that the critics had failed to appreciate the distinction between speculation and gambling: speculators were assuming economic risks that others wanted to shift; gamblers, on the other hand, were creating new and unproductive risks.<sup>18</sup>

Throughout the nineteenth century, however, whatever the possibilities of shifting valence for insurance or speculation might have been, it was clear to everyone that gambling was on the negative pole of human behavior: it was evil and immoral, as were the people who gambled. In order to legitimate endeavors that had been associated with gambling, one had to distinguish them from gambling, and in the process, it did not hurt to add your voice to those condemning gambling in the first place. As historian Ann Fabian has shown, gambling emerged as a “negative analogue,” a form of gain that made other efforts to acquire wealth seem normal and natural. Whereas speculative profits had once seemed dangerous and possibly destructive, they were surely less problematic than the unearned and illusory profits of gambling. Condemning wagers while embracing a speculative economy, the bourgeoisie “constructed an image of themselves as virtuous and

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<sup>15</sup> Zelizer, *Markets and Morals*, 45-46; 73.

<sup>16</sup> Unattributed, quoted in Charles A. Conant, “The Function of the Stock and Produce Exchanges,” in *The Functions of the Legitimate Exchanges* 15 (1910).

<sup>17</sup> Ann Fabian, *Card Sharps, Dream Books, and Bucket Shops: Gambling in 19<sup>th</sup> Century America* 154-162 (1990).

<sup>18</sup> See, e.g., James E. Boyle, *Speculation and the Chicago Board of Trade* 117 (1920); Conant, “Functions of the Exchanges,” 15; New York Cotton Exchange, *Dealings in “Options” and “Futures”: Protests, Memorials and Arguments Against Bills Introduced in the 52d Congress* (1892).

productive citizens by banishing their gambling doubles.”<sup>19</sup> Speculation was crucial for the economy, but “for the speculation to stay, the gambling had to go.”<sup>20</sup>

Like the attempt to legitimize speculation, the legitimization of insurance also involved the condemnation of gambling. Proponents of insurance, who included not only insurance salesmen and apologists for insurance companies, but also social reformers, attempted to overcome resistance to life insurance by portraying it as a moral building block in a complex society, where people ought not rely on the charity of the community, but rather should employ self-help and self-reliance in the form of provision for the future through insurance. One strategy for legitimizing insurance was the development of the doctrine of moral hazard. By claiming that the insurance industry itself would refuse to insure “moral hazards” the industry dissociated itself from those elements who would try to use insurance for gambling purposes. Gambling and insurance would be separated institutionally, in part through the attention to moral hazard. Tom Baker described the two-pronged uses of the concept: moral hazard would help the industry weed out the undesirable uses of insurance and at the same time would allow insurers “to claim innocence by association: Gambling is immoral; people who gamble are immoral; we and people we permit to buy insurance are moral (because we exclude the immoral); therefore, insurance is not gambling.”<sup>21</sup>

A late nineteenth-century critic summed up the opposition to various forms of gambling this way: “To deal with property on the principle of chance, which is non-moral, must be immoral because it involves the false proposition that property itself is non-moral.”<sup>22</sup> This statement crystallizes a deep-seated view of how the distribution of wealth and power was justified before the transition to a world run by “laws of chance.”

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<sup>19</sup> Fabian, *Card Sharps*, 4-5.

<sup>20</sup> *Id.* at 61.

<sup>21</sup> Baker, “Genealogy of Moral Hazard,” 258-259.

<sup>22</sup> W.D. MacKenzie, *The Ethics of Gambling* 43 (1895), quoted in David Dixon, *From Prohibition to Regulation: Bookmaking, Anti-Gambling, and the Law* 50 (1991). This outlook suggests a crucial point, which is that nineteenth century morality, and especially the ideology of self-reliance was based on a rejection of chance, and instead on an espousal of a doctrine of desert.

## “CONTRACTS” FOR “FUTURES”: COMMERCIAL SPECULATION AND THE GAMBLING STIGMA

Part of the transition to a world run by laws of chance was a shift in attitudes toward speculation, one of the important aspects of which was commodities trading. Commodities futures trading has an intimate relationship with contract law, both historically and linguistically. The development of expectation damages for breach of contract, and of the way to measure expectation (as the difference between contract price and market price at time of delivery) are closely tied to cases of speculative trading.<sup>1</sup> And when commodities traders discuss their work, they talk of buying and selling not wheat, cotton, or corn, but “contracts”. Commodities futures trading serves as a good model of what abstract contracting is about, its description falling clearly in line with mainstream modern contract theory. Transactions are bilateral executory promises to buy and sell a given amount of any commodity (gold, wheat, cotton, foreign currency) at a given price, on a given date in the future.

The development of organized exchanges, like the Chicago Board of Trade, allowed the nationalization of supply and demand in agricultural commodities, conforming to what economists today would call a sophisticated market supplying an efficient pricing mechanism.<sup>2</sup> But organized exchanges also provide for speculative transactions: people can, and frequently do, buy or sell with no intention of making or taking delivery of the product, but merely with the intention of liquidating their position before the date of delivery, hopefully at a profit. People conducting speculative trades can be specialists, whose vocation is trading on the exchanges, or simply outside investors who see particular trades as good investments. Or, people can use the exchanges to hedge. In other words, someone with an actual or expected holding of a commodity may make a futures transaction in order to prevent losses resulting from swings in the price of the commodity.<sup>3</sup> Today, such transactions, regardless of whether their motivation be physical sales, hedging, or pure speculation, are a completely integral and commonplace part of the market (as they are in the stock market). It is rarely considered that they could be outlawed

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<sup>1</sup> See Morton J. Horwitz, *The Transformation of American Law, 1780-1860*, p. 177 (1977).

<sup>2</sup> See generally Henry Crosby Emery, *Speculation on the Stock and Produce Exchanges of the United States* 54-74, 113-43 (Faculty of Political Science of Columbia Univ. ed., 1896); Jonathan Lurie, “Commodities Exchanges as Self-Regulating Organizations in the Late 19th Century: Some Perimeters in the History of American Administrative Law,” 28 *Rutgers L. Rev.* 1107 (1975).

<sup>3</sup> See 7 *Report of the Federal Trade Commission on The Grain Trade* 33-68 (1926). The most intuitive illustration of a hedging transaction involves the farmer (despite the fact that most hedgers are apparently dealers and not farmers): In January, the farmer expects to have grain for sale in July. By selling the July future in January, the farmer guarantees the price for the wheat, thus protecting against the possibility that the price of wheat will fall, leaving the farmer with a smaller return on what are already sunk costs. It should be noted that the farmer also gives up the possibility of gains in the event that the price of wheat rises in the intervening period.

as wagering contracts.<sup>4</sup> However, in the last quarter of the nineteenth century and actually, until definitive Federal regulation in the 1930's, the status of such speculative transactions was hotly contested. Indeed, at common law it was accepted that transactions for future delivery of property including stocks and commodities in which the parties did not intend actual delivery, but rather only settlement according to price differences, were unenforceable because they were mere wagers.<sup>5</sup> In most states, statutes (most of which are still on the books today) were passed expanding the common law position, sometimes criminalizing the transactions and sometimes granting the losers the right to recover their losses from the winners.<sup>6</sup>

But how is it that such transactions become susceptible to the charge that they involve gambling? Theoretically, it is difficult if at all possible to distinguish trades on the exchanges from other contracts of sale. A contract to sell goods for delivery in the future, which the seller does not own at the time, is not only legal but common. The fact that transactions are entered into "on margin" also does not brand them as wagers.<sup>7</sup> And the fact that the trades are often settled according to price differences rather than actual delivery of commodities simply signifies that contracting parties resolved a "breach" of the contract without recourse to the legal system, yet in accord with the legal remedy of expectation damages for breach of contract.<sup>8</sup> In other words, settling according to price differences is an instance of anticipatory breach, accompanied by payment of the difference between the contract price and the market price of the commodity at the time of breach.

The analogy to a simple contract of sale is illuminating here:<sup>9</sup> a defaulting seller's attempt to defend against a suit by claiming the contract is void as a wager because delivery was not contemplated would be ridiculed. But this situation is a perfect analogue

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<sup>4</sup> The ease with which we conceive of such transactions is, however, completely based on the existence of the organized exchanges: private individuals cannot create enforceable contracts with one another for futures, unless they actually intend delivery.

<sup>5</sup> See 3 Samuel Williston, *The Law of Contracts* §§ 1664a – 1670 (1<sup>st</sup> ed. 1920). A wager is defined as a contract performable only upon the happening of a condition which is a fortuitous event. In commodities speculation cases, the fortuitous event was the rise or fall in prices.

<sup>6</sup> See, e.g., Ala. Code 8-1-121(a) (1993); Ark. Code Ann. 23-44-105 (Michie 1994); Cal. Corp. Code 29008, 29100 (West 1977); Mass. Ann. Laws ch. 271, 35-36 (Law. Co-op. 1992); Mich. Comp. Laws Ann. 750.126, 750.127, 750.128 (West 1991); N.Y. Gen. Bus. Law 351 (McKinney 1988).

<sup>7</sup> See 3 Williston, *Law of Contracts*, §§ 1667 - 1669.

<sup>8</sup> Indeed, the analogy of market contracts to betting is a staple of economic thinking on contract: "The contract is then essentially a bet against the future course of the market..." John H. Barton, "The Economic Basis of Damages for Breach of Contract," 1 *J. Leg. Stud.* 277, 278 (1972).

<sup>9</sup> B contracts to buy a quantity of widgets from A on January 1<sup>st</sup>, to be delivered on April 1<sup>st</sup>, for 100. On March 1<sup>st</sup>, when the market price of widgets is 120, A announces that she cannot fulfill the contract, and pays B expectation damages of 20 (plus whatever down payment B initially made). To make the analogy even more obvious, assume that A is a wholesaler (i.e., a middleman), selling to a retailer; she is not concerned with the costs of production, but merely believes that between January and the end of March, she will be able to procure the widgets for less than 100.

to commodities trading from a pure analytic perspective. The important difference, of course, is the context. A host of factors militate against the occurrence of the anticipatory breach, the most important being (an assumed) lack of price volatility. Where, as in commodities contracts, the time between contracting and performance is significant, price volatility is an ingrained feature of the market, and day to day price differences can be turned into profits, the incentive to speculate on the rise and fall of prices takes on an importance that it does not have in contracts for widgets. Thus, the tendency of classical theorists to develop a general law of contract runs into an obstacle in the shape of the specific character of the market in question.<sup>10</sup> The pressure to decide commodities trading cases under the general rubric of contracts brings into sharp focus the problem of distinguishing these transactions from other contracts where speculation always lurks as a spectral possibility.

The facts of a typical case help set the stage for the discussion of the legal mechanism developed to distinguish between legitimate transactions and wagers. A miller comes to a broker, and arranges for a purchase of grain. The broker explains that the purchase will be made on the Chicago Board of Trade, according to the rules of the exchange, which formally require that every transaction include a commitment to make or take delivery by the specified date. The miller goes ahead with his order, the broker makes the trade on the exchange, in his own name, as is customary. Time goes by, and the price of grain goes down, at which time the miller decides to sell, taking a loss on the purchase and sale (paying the difference in prices), and paying commission to the broker for both trades. So far, not a very remarkable story. But then, the miller regrets his loss, and sues to recover on the basis of Illinois' anti-gaming statute, which voids trades made without the intention of taking delivery. He says that he never intended to take delivery of the grain,<sup>11</sup> and that if he nominally agreed to the terms imposed by the Board of Trade, he was not sincere in this part of the obligation, knowing in advance that he would liquidate his trade before the time of delivery. The broker answers that he was completely sincere in his intentions, regardless of those of his client, and that he engaged in legitimate transactions on the exchange. Further, he claims that the actual losses were paid to the opposing sides in the transactions, and if there was no delivery, it was because there was a set-off of trades, and thus, that the lost money (was not lost to him and) is not in his hands. The Supreme Court of Illinois sitting in 1916, however, rules against the supposed sincerity of the broker, and allows the miller to recover. The aptly named case, is *Miller v. Sincere*.<sup>12</sup>

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<sup>10</sup> On the tendency to generality and abstraction, see Lawrence M. Friedman, *Contract Law in America* 20-24 (1965); Christopher T. Wonnell, "The Abstract Character of Contract Law," 22 *Conn. L. Rev.* 437 (1990).

<sup>11</sup> Maybe he even offers evidence that his mill can only handle a small percentage of the grain contracted for, thus tending to show that the transaction was a speculation on prices. See *Pope v. Hanke*, 40 N.E. 839, 841 (Ill. 1894).

<sup>12</sup> 112 N.E. 664 (Ill. 1916). Further, in the actual case at hand, the broker claimed that a 1913 amendment to the anti-gaming statute exempted trades made on the Chicago Board of Trade according to its rules. The court however, held the amendment unconstitutional, saying that there was no reasonable basis for differentiating between transactions made on the Board of Trade and those made elsewhere (112 N.E., at 666):

In dozens, if not hundreds of like cases, turn-of-the-century transactors refused to pay debts to brokers, claiming that the transactions were illegal wagers. The actions divide into two groups: either (a) clients sued brokers to recover payments already made, relying on anti-gaming statutes that provided for recovery of money lost in gambling; or (b) brokers brought actions to secure payment of accounts, or of notes given in satisfaction of debts for similar trading activity, with the clients claiming they could avoid paying the notes because they were given as consideration for illegal wagering contracts.<sup>13</sup> Either way, the effective use of the anti-gaming statutes probably made the courts instrumental in reaching unintended consequences.<sup>14</sup>

The test of validity of transactions in commodities was the intention of the parties to perform under the terms of the contract, rather than to settle according to price differences.<sup>15</sup> The test acknowledges that the form<sup>16</sup> of legitimate and illegitimate contracts can be

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There is no reason why the Chicago Board of Trade, or stock exchange, or any other similar institution anywhere in the state, should be made a sanctuary for those who commit the crime of gambling on futures in grain or stocks. If it could lawfully be done, then it would be lawful to provide that persons could gamble at cards or with dice, or at other well-known gambling devices, in a board of trade or stock exchange building, but nowhere else. Conceding that there is ample reason for the enactment of criminal statutes against gaming and betting of all kinds, then a bet or wager which is made upon any uncertain event, whether it be the future price of grain, or the result of a race, or the turn of a card, or the cast of a die, would be no different in principle than other kinds of gambling. The test is always: Is the wager or bet upon any uncertain event or contingency?

<sup>13</sup> This defense, supported in many states by statute, often succeeded. See, e.g., *Kuhl v. M. Gally Universal Press Co.*, 26 So. 535 (Ala. 1898); *Gardner v. Meeker*, 48 N.E. 307 (Ill. 1897); *Swinney v. Edwards*, 55 P. 306 (Wyo. 1898). See also 3 Williston, *Law of Contracts*, §§ 1675-1677.

This raises one of the important doctrinal issues involved in speculative trading cases. While functionalist histories of contract have maintained that the financial interests of the merchant class demanded and achieved full negotiability of standard financial instruments, we see that in this paradigmatically commercial context, negotiability was thwarted when it could be associated with gambling. Thus, the financial interest in speculation was not strong enough to overcome the stigma of gambling, undermining the functionalist narrative of the development of commercial law. For a sophisticated version of the functionalist narrative, see Horwitz, *Transformation of American Law*, 211-226.

<sup>14</sup> In both types of cases, it should be kept in mind what an effective use of an anti-gambling statute involves on the part of the person making the trades. When she wins, she collects her winnings, since the brokers are interested in generating business, and the members of the exchange are making trades, and paying out profits when people make them. When she loses, she still wins, because she comes back to the broker and claims the transactions were void wagers. The courts then, rather than effectively eliminating the practice of wagering, are actually giving people a license to gamble, and a guarantee against losses. But of course, this is just an amusing curiosity or a mild absurdity on the level of unintended incentives.

<sup>15</sup> Summing up the common law position on such transactions in 1920, Williston writes:

The test adopted in the absence of statute distinguishes between agreements to buy and sell in which an actual delivery of the property is contemplated, and similar agreements in which it is contemplated merely that a settlement shall be made between the parties based on fluctuations in the market price. An agreement of the former kind is legal; one of the latter kind involves wagering and is illegal.

identical. The distinction relies on the ability of the courts to determine whether the legitimate form was a ruse to cover an illegitimate transaction. In this light, the test of validity seems to be the same as that for any contract with an illegal purpose.<sup>17</sup> However, the application of this test in the commodities context turns out to be anything but simple.

Two related issues present themselves for analysis: first, the relatively theoretical question of whether the search for intent implies that we are in the realm of the subjective theory of contract; and second, the question of how intent will be determined by the court. While it may appear that the former issue should provide a conclusive answer to the latter, in fact, both the subjective and objective views allow for significant latitude in determining what kinds of arguments or evidence will convince a court of the legitimacy or illegitimacy of a particular transaction.

### Wagers and the Objective Theory of Contract: A Prelude to the Question of Intent

The contest between objective and subjective theories of contract takes on a puzzling aspect in the context of commodities trading. On the one hand, given that the form of commodities transactions was identical in cases where the transaction was sometimes held valid and sometimes invalid, and given that the form of the contract was in essence identical to other contracts for the sale of goods, a strictly objective test of the contract would seem to imply that the contracts would always be valid.<sup>18</sup>

According to this standard, if contracts for the sale of commodities were ever allowed, none would be singled out for disqualification unless the parties made an overt provision for the fact that no delivery would be made, and that the transaction would be settled according to price differences. Most commentators agree that the objective theory of contracts does in fact hold sway, and that its victory over subjective theory was complete

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3 Williston, *Law of Contracts*, § 1670 (The heading for this section is: “Test of validity is intent to make actual delivery.”).

<sup>16</sup> By form here I mean the conduct or outward manifestations or expressions of intent deemed the essential element of contract by the objective theory of contract.

<sup>17</sup> For instance, if A contracts to deliver “a package” to B, where both A and B know that the “package” is stolen goods or a code word for a murder, the contract is clearly illegal and unenforceable. Freedom of contract runs out where the purpose of the contract is criminal.

<sup>18</sup> The most famous expression of the strict objective view is Judge Learned Hand’s statement:

A contract has, strictly speaking, nothing to do with the personal, or individual, intent of the parties. A contract is an obligation attached by the mere force of law to certain acts of the parties, usually words, which ordinarily accompany and represent a known intent. If, however, it were proved by twenty bishops that either party when he used the words intended something else than the usual meaning which the law imposes on them, he would still be held, unless there were mutual mistake or something else of the sort.

Hotchkiss v. National City Bank, 200 F. 287, 293 (S.D.N.Y. 1911), aff’d, 201 F. 664 (2d Cir. 1912), aff’d, 231 U.S. 50 (1913). For theoretical defense of the objective theory see, Samuel Williston, “Mutual Assent in the Formation of Contracts,” 14 *Ill. L. Rev.* 85 (1919).

by the beginning of the twentieth century.<sup>19</sup> But in fact, the cases on commodities trading show that issues of subjective intent were still important well into the twentieth century.

The consideration of intent in this context throws some doubt on the traditional narrative regarding the ascendance of the objective theory. That narrative acknowledges that in some marginal cases, especially those cases that raise problems of fraud and duress, intent can be a relevant category. But the centrality of intent in cases where agreements are completely voluntary and the context is purely commercial, conditions that are routine in the commodities context, shows that the narrative of the marginality of policing agreements through the mechanism of intent is overstated. The ascendance of objective theory is often presented either as part of the progress of rationality in contracts, or as part of a progressive dominance of business interests and their desire for stability in contract law, but such progress narratives should be viewed with suspicion.<sup>20</sup>

A look at some case law fleshes out the puzzling quality of the conflict over subjective and objective theories. Courts were generally in agreement that contracts would only be valid where the parties, “*really intend* and agree that the goods are to be delivered by the seller, and the price to be paid by the buyer.”<sup>21</sup> The repeated phrase betrays the central sticking point: the search for the elusive quality called “real intent”. The language employed in an Iowa Supreme Court case from just before the turn of the century is suggestive here. Defendant refused to pay debts to a broker on orders to buy grain, claiming that the transactions were wagering contracts, and void. The court, in deciding whether the trial court was justified in admitting “the uncommunicated motive or intention of the defendant” into evidence, wrote:

It is not enough, to render a contract void, that the buyer intends it as a gambling contract, unless the seller participates in that intention; that is, if, in the case at bar, the defendant, in ordering the purchase of the oats, only intended a speculation upon margins, without delivery of grain, and the plaintiff purchased the grain for actual delivery, it would not be a gambling contract. To make the contract void as between these parties, the intention to make a gambling contract must have been mutual.<sup>22</sup>

As far as the objective theory of contracts is concerned, this passage highlights the ambiguity of the courts’ treatment of wager contracts. On the one hand, the normal

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<sup>19</sup> See E. Allan Farnsworth, *Contracts* 117-18 (3d ed. 1999)

<sup>20</sup> See Lawrence M. Friedman, *Contract Law in America* 86-87 (1965); Lon Fuller, “Consideration and Form,” 41 *Colum. L. Rev.* 799, 808 (1941); Morton J. Horwitz, *Transformation of American Law*, 201.

<sup>21</sup> *Embrey v. Jemison*, 131 U.S. 336, 344-345 (1889). The court continues:

If, under guise of such a contract, the real intent be merely to speculate in the rise or fall of prices... then the whole transaction constitutes nothing more than a wager, and is null and void...[I]n this country, all such contracts are held to be illegal and void as against public policy... Gambling is none the less such because it is carried on in the form or guise of legitimate trade.

<sup>22</sup> *Counselman v. Reichart*, 72 N.W. 490, 491 (Iowa 1897).

situation is to expect mutual intention even where none really exists, so long as there are manifestations of intent. The manifestations of intent are taken as a proxy for real intent, deemed unnecessary. Williston's exposition of the objective theory is clear on this point: "[T]he words and acts of the parties are themselves the basis of contractual liability, and not merely evidence of a mental attitude required by the law. In other words...an expression of mutual assent, and not the assent itself, is the essential element of contractual liability."<sup>23</sup> Here however, real mutual intent is not only unnecessary to the contract, it is fatal. In other words, there is one kind of contract which cannot suffice with objective manifestations of intent: the gambling contract. But when you succeed in making the gambling contract, you undermine the commodities contract. The emphasis on "real intent" seems to suggest a clinging to subjective theory, but perhaps this is a case of objective theory at the extreme: the contract exists as valid *only* where there is no mutual intention.<sup>24</sup> However, despite theoretical support for the proposition, it presents a more coherent polemic for the objective theory than the cases will support.<sup>25</sup> In fact, the courts shy away from fixed determinations on the question of whether they adhere to an objective or subjective theory, allowing juries to divine the "real intent" of the parties that is supposed to determine the outcome of the cases.

#### Determining the Intent of the Parties

Beyond the theoretical question of subjective or objective accounts of contract, the central problem in the commodities trading cases, viewed as a group, is how to determine intent. An influential Supreme Court decision, *Irwin v. Williar*,<sup>26</sup> laid down an oft-quoted formulation for the task. In that case, plaintiffs were brokers who sued for a debt incurred by a partnership, the surviving partner of which was the defendant. The defendant raised two defenses: first, that the deceased partner exceeded the scope of his authority by making speculative trades in grain, far beyond the needs of the grain business in which the partnership was legitimately engaged;<sup>27</sup> second, that the transactions were wagers and thus

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<sup>23</sup> Williston, "Mutual Assent," 87.

<sup>24</sup> Williston's treatment of the issue relies precisely on this logic:

The importance of observing that objection to recovery is not so much the character of the contracts as the guilt of the plaintiff is illustrated in wagering contracts of this sort; for if either of the parties contracts in good faith, intending that the goods shall be actually delivered, he is entitled to the benefit of his contract, no matter what may have been the secret purpose or intention of the other party; while the party guilty of an intent to gamble cannot recover.

<sup>3</sup> Williston, *Law of Contracts*, § 1671 (footnotes omitted).

<sup>25</sup> See, e.g., *Miller v. Sincere*, 112 N.E. 664 (Ill. 1916); *Counselman v. Reichart*, 72 N.W. 490 (Iowa 1897); *Soby v. People*, 25 N.E. 109 (Ill. 1890); *Waite v. Frank*, 86 N.W. 645 (S.D. 1901); *Mackey v. Rausch*, 15 N.Y.S. 4 (Sup. Ct. 1<sup>st</sup> Dep't, 1891); *Embrey v. Jemison*, 131 U.S. 336 (1889). In many of the cases, where there was no direct evidence of an intent to wager, courts upheld verdicts of juries who concluded that the mutual intent was to wager.

<sup>26</sup> 110 U.S. 499 (1884).

<sup>27</sup> To make a claim for implied authority of the deceased partner, the plaintiffs showed that the partnership was involved in "dealing in grain" and that it took or made deliveries on some of its orders, while making

void, and that therefore the debt was also void. On this point, the Court accepted the jury instructions mandating that a “transaction which on its face is legitimate cannot be held void as a wagering contract by showing that one party only so understood and meant it to be. The proof must go further, and show that this understanding was mutual – that both parties so understood the transaction.”<sup>28</sup> Further, the Court elaborated the point that all the circumstances of the transactions could be relevant in determining intent:

We do not doubt that the question whether the transactions came within the definition of wagers is one that may be determined upon the circumstances, the jury drawing all proper inferences as to the real intent and meaning of the parties; for, as was properly said in the charge, ‘it makes no difference that a bet or wager is made to assume the form of a contract. Gambling is none the less such because it is carried on in the form or guise of legitimate trade.’ It might therefore be the case that a series of transactions, such as that described in the present record, might present a succession of contracts, perfectly valid in form, but which, on the face of the whole, taken together, and in connection with all the attending circumstances, might disclose indubitable evidences that they were mere wagers. The jury would be justified in such a case, without other evidence than that of the nature and circumstances of the transactions, in reaching and declaring such a conclusion.<sup>29</sup>

At first glance, this formulation seems to adopt a stance advocating full disclosure of any relevant circumstances. But the balanced rhetoric of the passage is misleading. Plaintiffs in this case attempted to show that they had no intention of gambling by proving that the defendant had made or taken delivery on some of their orders, and that the custom of traders on the exchange of which they were members required delivery, either of actual grain or by set-off. While the trial court admitted evidence of such custom, the Supreme Court reversed, saying that since there was no evidence that the defendants had knowledge of such custom, it did not bind them.<sup>30</sup> In effect, then, the Court was willing to consider all relevant circumstances that might tend to show an intent to gamble, but unwilling to consider circumstances that could have shown intent to make delivery. This imbalance is just one instance that exhibits how much latitude the courts retain in determining the

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counter transactions before the date of delivery on others. The trial court ruled that the partnership’s legitimate “dealing in grain” made all the transactions facially authorized. The Supreme Court reversed this holding, saying that “Dealing in grain is not a technical phrase from which a court can properly infer as a matter of law authority to bind the firm in every case irrespective of its circumstances.” 110 U.S. at 507. The interesting thing about the reversal is the court’s willingness to complicate the factual determination on the basis of a distinction between grain for the milling business and grain for speculation, without taking into account the possibility of hedging. This determination is part of the Court’s overall negative orientation toward speculative trading.

<sup>28</sup> Id. at 507-508.

<sup>29</sup> Id. at 510-511.

<sup>30</sup> Id. at 513-516.

meaning of the circumstances, even when they declare that they are searching for the real intent of the parties.

The interpretation of circumstances surrounding a particular transaction often depends on a series of presumptions regarding commodities trading generally, or particular features of commodities trading, through which the court can impose economic sympathies or antagonisms. For instance, in *Counselman v. Reichart*, the court announced that for a transaction to be invalidated as a wager, the intention to gamble must be mutual. However, it did not require that intention be communicated between the parties, and it was undisturbed by a lack of direct evidence as to a gambling intent, because of a presumption regarding the commodities exchanges themselves:

In view of the generally known fact that business on the board of trade is conducted on a plan of nondelivery of produce, but as a speculation in margins or differences, it may well be stated that the fact of whether there was to be a delivery of the grain in question was one of understanding between the parties, independent of the orders for purchases.<sup>31</sup>

In other words, the court was willing to presume that trades carried out on the organized exchange are gambling contracts, and this despite the fact that in the case at hand, some of the defendant's orders were settled by actual delivery of grain.<sup>32</sup> On the other hand, some courts, even while sharing the assumption that many or most trades on the exchanges are a form of gambling, work out the opposite legal presumption, relying on the fact that the trades were carried out on organized exchanges as evidence of their legitimacy.<sup>33</sup> Brokers routinely included boilerplate language on their letterheads that all transactions contemplated actual delivery, and courts alternatively credited or ignored them, again exposing both the courts' latitude in determining intention and the relatively tenuous hold that objective theory had on the outcome of the cases.

The relationship of clients to brokers was another area of discord among various courts. As Williston points out, "If a transaction is carried out on an Exchange...it seems difficult to see why an agreement between the broker and customer that the latter should only be required to settle differences, should make the transaction any more objectionable."<sup>34</sup> However, courts sometimes denied brokers recovery, even when they

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<sup>31</sup> 72 N.W. 490, 491 (Iowa 1897).

<sup>32</sup> A similar presumption seems to motivate the court in another case where some orders had been settled by actual delivery. *Pope v. Hanke*, 40 N.E. 839 (Ill. 1894).

<sup>33</sup> See, e.g., *Bank of Ettrick v. Emberson*, 196 N.W. 861, 866 (Wis. 1924):

It is undoubtedly true that the great majority of contracts made through the agency of boards of trade are gambling contracts... On the other hand, a vast amount of important and legitimate business is carried on every day through the agency of boards of trade. Speculation is not necessarily gambling, and contracts to be consummated on boards of trade, if intended to be carried out in good faith, are as legitimate as the innumerable other contracts made in the business world in which gains or losses may depend on changes in market values.

<sup>34</sup> 3 Williston, *Law of Contracts*, § 1672.

acknowledged that they had made legitimate trades on the exchanges. “[I]n Illinois, Massachusetts, and doubtless most other States, the agreement between the customer and broker may be held invalid though the transactions contemplated on the Exchange were valid.”<sup>35</sup> In the latter type of cases,<sup>36</sup> a stark injustice arises: the courts recognize that the brokers have made good on their commitments to the other members on the exchange with whom they traded; nonetheless, the courts void agreements between the brokers and the client, leaving the broker to bear the loss, while the client is never required to return any gains that may have resulted from previous trading.

On the other hand, some courts were willing to grant brokers a certain type of privilege, by assuming that “reputable brokers” would not make agreements that amounted to gambling contracts. One such case was *Cohen v. Rothschild*,<sup>37</sup> where the court was faced with contradictory testimony as to the agreement between broker and client. The client testified that there was an understanding between the parties that no contract should ever be retained until delivery, and thus that all transactions would be settled according to price differences. The broker denied any such understanding. The trial court appointed a referee, who found that a mutual understanding existed, but the Appellate Division reversed, saying simply, “It is improbable, I think, that the defendants, who so far as appears are reputable brokers, would have made such an agreement.”<sup>38</sup> In this case, then, an appellate court was willing to overrule a finding of fact, merely on the presumption that reputable brokers would not open themselves up to charges of gambling. At the very least, a ruling based on such a presumption is a clear indication that the search for intention was influenced by courts’ more general orientation towards commodities trading and even more generally, speculation. More pointedly, it can be read as evidence for the proposition that the intent of the parties was not much more than a fig leaf for the courts’ policy determinations regarding the legitimacy of commodities trading.

A similar conclusion was reached by Edwin Patterson in his 1931 article, *Hedging and Wagering on Produce Exchanges*.<sup>39</sup> Patterson sets out to unravel the “compromise with the devil” necessary to distinguish hedging from wagering. He notes that while judges and text-writers rarely mention the issue overtly, the basis for their opposition to wagers has two sources: “the moral sentiments of the community” which he identifies as Puritan on the one hand, and the anti-social consequences of encouraging non-productive activity on the other. Patterson’s article is a protest against a legal test “too narrow to satisfy the requirements of social and economic policy,”<sup>40</sup> and an attempt to encourage

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<sup>35</sup> *Id.* (footnotes omitted).

<sup>36</sup> Examples of cases where courts found that brokers made legitimate trades on exchanges and yet allowed clients to void their contracts with brokers as wagers include *Waite v. Frank*, 86 N.W. 645 (S.D. 1901); *Counselman v. Reichart*, 72 N.W. 490 (Iowa 1897).

<sup>37</sup> 169 N.Y.S. 659, 660-62 (App. Div. 1918).

<sup>38</sup> *Id.* at 662.

<sup>39</sup> Edwin W. Patterson, “Hedging and Wagering on Produce Exchanges,” 40 *Yale L.J.* 843 (1931).

<sup>40</sup> *Id.* at 862.

legislative modification of the law. He distinguishes among three variants of the test of intentions,<sup>41</sup> with a persistent theme that the tests allow courts considerable latitude in interpreting evidence:

A court which is hostile to speculation in futures will draw the introspective inference that *B* was aware, when he made the agreement, of *A*'s intent to gamble; while a court friendly to the produce exchanges will, on facts scarcely distinguishable, decline to draw such an inference. *This is not the first time that introspective terminology has been used as camouflage for unarticulated theories of policy.*<sup>42</sup>

Convinced that courts cover over their policy determinations with the test of intentions, Patterson is at pains to offer a practical solution that will allow the legitimate mechanism of hedging to survive, but will not grant unlimited license to gambling. In this quest, however, he does not view his detailed analysis as completely successful, and just before concluding with some unanswered questions and a few limited suggestions, he writes: "In endeavoring to distinguish hedging from wagering, the courts are between the devil and the deep sea."<sup>43</sup> It is precisely this sense of being between two perilous options that I will focus on in examining the policy discussions that swell up in judicial rhetoric.

#### Speculation in Everyday Business

Before going on to the policy analysis, it is worthwhile to point out that there is another, more general way to expose the gap that policy must fill in making the decisions that distinguish between gambling and legitimate commodities trading. At about the same time the Supreme Court of Illinois was deciding dozens of commodities speculation cases based on trades conducted on the Chicago Board of Trade, it decided the case of *Schlee v. Guckenheimer*.<sup>44</sup> In that case, plaintiff was the owner of a brewery, and contracted with defendant for the purchase of barley for his brewery. The terms of the contract provided for delivery of 4000 bushels of barley at 57 cents a bushel on 15 October, and an option to purchase up to 20,000 additional bushels at the same price any time up to 31 December. The plaintiff ordered the additional 20,000 bushels in mid-November, but, the price of barley having risen, the defendant refused to make delivery, and defended claiming that the contract was a wagering contract under the statute forbidding gaming, and thus void. The trial court and the appellate court ruled in defendant's favor, but the Illinois Supreme Court reversed, saying,

This proposition or offer is similar to everyday business transactions among the people of this state with reference to every character of commodities purchased

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<sup>41</sup> Id. at 856-63. He identifies "Undisclosed Intention of One Party," "Disclosed Intention of One Party," and "Bilateral or Mutual Intention Not to Deliver" as the three varieties of intentions test.

<sup>42</sup> Id. at 860 (emphasis added).

<sup>43</sup> Id. at 878.

<sup>44</sup> 54 N.E. 302 (Ill. 1899).

for use. The offer to sell such a commodity at a specified price, if accepted by a specified time, does not constitute a violation of the statute. Its acceptance within that time is not prohibited or made a criminal offense, but is an everyday transaction, necessary in carrying on business.<sup>45</sup>

To the modern eye, it seems clear that the Illinois Supreme Court got it right, that the transaction was not a gambling contract, and that the lower courts simply erred. But is this so obvious? As far as the language of the gaming prohibition was concerned, the lower courts were applying a clearly worded statute.<sup>46</sup> In fact, in a case with almost identical pertinent facts, but dealing with an option to buy stock rather than barley, the same court reached the opposite conclusion.<sup>47</sup> In these cases, then, the courts are not dealing with the question of intent, but rather trying to distinguish more broadly between regular business contracts and speculative contracts. The problem is that there is no formalistic or analytical distinction between these types of contracts.<sup>48</sup> True, a case such as this represents only an instance of statutory interpretation that avoids what many would consider an absurd result. In that sense, it can almost be explained away, dismissing the tension that links gambling and legitimate contracting. But how is one to distinguish between the “everyday business” of a sale of barley that includes an option from the everyday business of options in stocks? While the answers that legal decision making provides, even in the case at hand, may be more convincing intuitively than in the cases where a test for intention to make delivery is at stake, the distinction is still ultimately “a proposition of policy of rather a delicate nature.”<sup>49</sup> At this point, we can proceed to an exploration of some of the policy considerations articulated and suggested by the case law.

### Policy in the Cases

Sometimes courts express their policy inclinations in the clearest language possible. One example is the oft cited case of *Cothran v. Ellis*, where a client refused to pay notes he had drawn to pay a debt on futures transactions. After discussing the statutory and common law treatment of wagers, the court vents its hostility to speculation, exhibiting both the puritan strain and the concern for anti-social consequences identified by Patterson. The opinion speaks for itself, and merits quotation at some length:

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<sup>45</sup> Id. at 304.

<sup>46</sup> The code provision in question held that “Whoever contracts to have or give to himself or another the option to sell or buy at a future time any grain or other commodity, stock of any railroad or other company...shall be fined...and all contracts made in violation of this section shall be considered gambling contracts, and shall be void.”

<sup>47</sup> See *Schneider v. Turner*, 22 N.E. 497, 499 (Ill. 1889). In that case, the court noted that the contract “could have been made the disguise for gambling on the future price of stock.” And, commenting on the fact that the statute may have been a case of legislative overreaching, the court said, “The treatment is heroic, but the evil [gambling on fluctuations in stock and commodity prices] was most malignant.”

<sup>48</sup> For the same problematic as it arises in the context of requirements contracts, see *National Publishing Co. v. International Paper Co.*, 269 F. 903 (2d Cir. 1920).

<sup>49</sup> Oliver Wendell Holmes, Jr., “Privilege, Malice and Intent,” 8 Harv. L. Rev. 1, 8 (1894).

[W]e are clearly of opinion that dealing in ‘futures’ or options’ as they are commonly called, to be settled according to the fluctuations of the market, is void by the common law; for, among other reasons, it is contrary to public policy. It is not only contrary to public policy, but it is a crime, – a crime against the state, a crime against the general welfare and happiness of the people, a crime against religion and morality, and a crime against all legitimate trade and business. This species of gambling has become emphatically and pre-eminently the national sin. In its proportions and extent it is immeasurable. In its pernicious and ruinous consequences it is simply appalling. Clothed with respectability, and entrenched behind wealth and power, it submits to no restraint, and defies alike the laws of God and man. With despotic power it levies tribute upon all trades and professions. Its votaries and patrons are recruited from every class of society. Through its instrumentality the laws of supply and demand have been reversed, and the market is ruled by the amount of money its manipulators can bring to bear upon it. These considerations imperatively demand at the hands of the courts of the country a faithful and rigid enforcement of the laws which have been ordained for the suppression of this gigantic evil and blighting curse.<sup>50</sup>

The rhetoric of the passage is self-consciously startling. A modern sensibility is likely to discount the religious elements, but it would be a mistake to overlook the sense of danger expressed in the imagery. Legitimate trade and business and even the laws of supply and demand are threatened, waging what appears to be a losing battle against a despotic, gigantic, evil, blighting curse. “Clothed with respectability, and entrenched behind wealth and power,” we find, not a policy of industrialization that drives the working poor into inhuman living conditions, but rather the “national sin”, the curse and crime of gambling in futures. It is precisely rhetoric like this to which Ann Fabian refers when she says that “the bourgeoisie...constructed an image of themselves as virtuous and productive citizens by banishing their gambling doubles.”<sup>51</sup>

Not all courts were so evangelical or so willing to make their policy inclinations plain or overt. Often, policy considerations can be seen in the courts’ presentation of facts or conclusions of law. The following pair of contrasting cases, separated by nearly fifty years, offers some indication. In *Jamieson v. Wallace*, the court made a “careful examination of the evidence” in order to decide whether in fact the parties intended to wager, and especially whether the brokers knew that the client had no intention to take delivery.<sup>52</sup> In ruling against the brokers, the court noted that the appellee was a woman of limited means with no business experience whose trades were well beyond her holdings, throwing doubt on whether she understood the obligations entailed in the transactions.<sup>53</sup>

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<sup>50</sup> Cothran v. Ellis, 16 N.E. 646, 648 (Ill. 1888).

<sup>51</sup> Ann Fabian, *Card Sharp, Dream Books, and Bucket Shops: Gambling in 19<sup>th</sup> Century America* 5 (1990).

<sup>52</sup> 47 N.E. 762 (Ill. 1897).

<sup>53</sup> See id. at 765:

In *Salzman v. Boeing*, on the other hand, the court dealt with similar facts, where plaintiff said that, “She had never before been to a broker’s office or had an account with a broker’s business,” and claimed that “her inability to pay for the large amount of wheat purchased by her shows conclusively that the intention was not to take delivery.”<sup>54</sup> The court, however, ruled that, “The conclusive answer to this contention seems to be that...she was able to take delivery and took it, although it seems to have wiped out her account.”<sup>55</sup> The court concludes thus: “It is to be regretted plaintiff sustained a loss she could illly afford to bear. She was, however, responsible for her own misfortune notwithstanding the observance of every restriction provided by law for her protection. The law has emancipated women.”<sup>56</sup>

Two cases with like facts, separated by half a century. In the first, clearly articulated, is a policy of paternalism. Speculating brokers are on the prowl, looking for unsuspecting dupes, (ideally women), ready and waiting to take advantage of them by luring them into gambling transactions sure to be their ruin. In the second, women, like everybody else, are expected to live up to a standard of responsibility for their economic endeavors, and the anti-gambling statutes will not be a stand-in for failed paternalism. “The law has emancipated women.”

The question of paternalism, however, is not the central policy issue for cases that turn on distinguishing gambling from speculative but legitimate business. The more central policy discussion can be seen in an opinion written by Justice Holmes in 1905. In *Board of Trade of the City of Chicago v. Christie Grain & Stock Co.*,<sup>57</sup> the Board of Trade prayed for an injunction against a bucket shop<sup>58</sup> that was using price quotations from the exchange for its speculative trading business. The bucket shop defended by claiming that the Chicago Board of Trade was “the greatest of bucket shops,” in the sense that it was a place that permitted “the pretended buying and selling of grain, etc., without any intention of receiving and paying for the property so bought, or of delivering the property so sold.” Being a bucket shop itself, the Board of Trade could not claim property for its price

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The appellee was a woman who had little or no experience in business...She was a woman of very limited means...From her relations to the appellants, and from all the circumstances disclosed by the proof, it is impossible to believe that they were not well acquainted with the limited extent of her means. A woman who was not active in business and had only \$7,500 in money, could not have been expected to take and pay for stocks amounting in value to \$17,500. Appellants never made any inquiry of her as to her financial ability...She swears that she did not understand that the stocks proposed to be purchased were to be paid for by her.

<sup>54</sup> 35 N.E.2d 536, 538-39 (Ill. App. Ct. 1941).

<sup>55</sup> Id. at 538, 539. It should be noted that delivery in this case was by set-off and payment; by this standard, appellee in *Jamieson* also “took delivery.”

<sup>56</sup> Id. at 540.

<sup>57</sup> 198 U.S. 236 (1905).

<sup>58</sup> Bucket shops were establishments where prices of commodities were posted, and people made ‘trades’ with small sums of money (e.g., \$5), as ‘margin’, gaining ‘profits’ if the prices went their way. In effect, these were substitutes for lotteries or horse-racing as modes of gambling with small sums.

quotations. Justice Holmes dismisses the defense, saying that even if the activities are illegal, the price quotations could still be property. But before declaring this bottom line, he analyzes the underlying reasons for allowing trading on the Exchange. In so doing, he begins to spell out the economic policy behind speculative trading, calling speculation “the self-adjustment of society to the probable,” and saying that its value is “well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want.”<sup>59</sup>

Holmes goes on to cite the importance of hedging for dealers in grain and for farmers themselves, noting that trades on the Exchange are consistent with the good faith of the parties and their “serious business purposes.” Extending the point, he notes that “the quotations of prices from the market are of the utmost importance to the business world, and not least to the farmers.”<sup>60</sup> Holmes concedes that the Exchange may be used for pretended trades or gambling purposes, but sees that as an unfortunate side effect that must be tolerated for the sake of a modern economic order. Holmes’ position then, is relatively clear: despite dressing up his discussion with a reference to the good faith of the parties and their serious business purposes, he acknowledges that the mechanism of the Board of Trade can be and is used for speculation or gambling. He acknowledges, also, that a formal legal theory will not be able to articulate a rule that distinguishes between the speculative or gambling contract and the legitimate business contract. And, at the same time, he shows that even the speculative element is part of the modern business world, because it helps to set prices in accordance with supply and demand, eventually creating efficient markets.<sup>61</sup>

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<sup>59</sup> 198 U.S., at 247-48. The flavor of the passage is worth quoting in full:

As has appeared, the plaintiff’s chamber of commerce is, in the first place, a great market, where, through its eighteen hundred members, is transacted a large part of the grain and provision business of the world. Of course, in a modern market, contracts are not confined to sales for immediate delivery. People will endeavor to forecast the future, and to make agreements according to their prophecy. Speculation of this kind by competent men is the self-adjustment of society to the probable. Its value is well known as a means of avoiding or mitigating catastrophes, equalizing prices, and providing for periods of want. It is true that the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn. But legislatures and courts generally have recognized that the natural evolutions of a complex society are to be touched only with a very cautious hand, and that such coarse attempts at a remedy for the waste incident to every social function as a simple prohibition and laws to stop its being are harmful and vain.

<sup>60</sup> *Id.* at 249.

<sup>61</sup> Of course, I am putting current economic terminology into Holmes’ pen here, but the argument does emerge, more or less, from his opinion in the case. To recall just how radical Holmes’ policy statement was at the time, we have only to look the rhetoric of a prior Supreme Court opinion dealing the same issues. In one such case, the court held:

The plea makes a case of money advanced...solely for the purpose of carrying ‘cotton futures’...when neither party contemplated the purchase or delivery in fact of cotton, and when it was understood that any settlement in respect to such purchases should be exclusively upon the basis of...the difference between the contract price and the market price...If this be not a

Thirty-seven years later, the Supreme Court of Illinois, faced again with a defense to a debt based on the claim that commodities transactions were wagering contracts, could take up Holmes' policy discussion in an even more striking and generalizing manner, at this point relying also on congressional regulation of the commodities exchanges:

The titles to the various acts of Congress make it clear that our public policy now recognizes the desirability and necessity of maintaining open markets, even if they sometimes be used for gambling, in order to stabilize values in commodities and securities. As briefly mentioned in the Monroe case, every human transaction is a gamble, which all must take whether they wish to or not. From the time he plants his seed until he sells his crop, every farmer is gambling. From the time he makes a contract of sale until he delivers the flour, every miller is gambling. The public policy has been declared to be that these contracts for future delivery are necessary to the commerce of the people of the United States in their domestic interstate economy, and since no one can tell with what intent they are entered into, it is impossible to pick and choose among them.<sup>62</sup>

This is the articulation of a modern consciousness. It sounds like simple, familiar, and sound economic policy. But in summing up a new vision of the law's relationship to speculation, it highlights the fact that more was at stake than the debt of an unlucky speculator. A tension emerges in the judicial treatment of wagers. Judges articulate a distinction between a permitted and a prohibited contractual form, but face a difficulty in applying the distinction to formally identical transactions. In response, they shifted the locus of inquiry to the question of intent, only to find that determinations of intent yielded to the same cultural and political conflict that necessitated the original distinction.

The judges, if not the speculators, of the late nineteenth century lived in a different normative universe. Their attempt to limit gambling was tightly bound up with a vision of what the community could tolerate, and still remain a community. And the shift to an idea of a community that must tolerate gambling, a community in which speculation is necessary ("these contracts for future delivery are necessary to the commerce of the people of the United States"<sup>63</sup>), is one made up of different components from the community that preceded it. In part, the decline of the rhetoric of moral opposition toward gambling and the rise of a rhetoric that accepts the necessity of speculation, judging the legitimacy of action by its economic consequences, marks a shift that allows people to recognize themselves in statistics. People become subjects of the law of large numbers, more than subjects of a culturally specific and recognized moral authority.

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wagering contract, under the guise of a contract of sale, it would be difficult to imagine one that would be of that character. The mere form of the transaction is of little consequence. If it were, the statute against wagers could easily be evaded.

Embrey, v. Jemison, 131 U.S. 336, 343-344 (1889).

<sup>62</sup> Albers v. Lamson, 42 N.E.2d 627, 630 (Ill. 1942).

<sup>63</sup> Id.

Regulation as opposed to prohibition of gambling raises an analogy to analyses of the dual role played by administrative organization in modernization. On the one hand, state activities like cadastral mapping and imposition of a simplified property regime enable the state to organize the populace, and especially to tax efficiently. On the other hand, however, the state's activity also plays a more active role, eventually transforming the individuals under its control. In our context, the state (in the form of the courts) becomes less interested in the moral intentions of the actors in question, content instead to address the overall economic consequences of their aggregate activity (here, speculative investment that creates and supports an efficient pricing mechanism). While the regulation of gambling is far from the grandiose administrative action accompanying modernization, a similar dynamic plays itself out, at least for the limited sector of the populace exposed to the courts' treatment of such cases. Exposed to an official narrative that judges actions by their place in an overall economic system, people begin to envision themselves, or at least to recognize themselves, as (interchangeable) parts of that system, subject to its (economic) laws.<sup>64</sup> The law of large numbers plays an even more central and overt role in the next topic to be addressed, the law of life insurance.

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<sup>64</sup> See James C. Scott, *Seeing Like a State: How Certain Schemes to Improve the Human Condition Have Failed* 37-52, 90-93 (1998).

## WAGERING IN LIVES: THE LIFE INSURANCE SPECULATORS

[P]aradoxical as it may appear, there is a class of gambling which is not only considered harmless, but beneficial, and even necessary – I mean Insurance. Theoretically, it is gambling proper. You bet 2s. 6d. to £100 with your Fire Insurance; you equally bet on a Marine Insurance for the safe arrival of your ships or merchandise; and it is also gambling when you insure your life.<sup>1</sup>

-- John Ashton, 1898

How is it that Ashton is so confident that “theoretically,” insurance is “gambling proper”? And what of the phrase “gambling proper” itself? Does it refer to gambling, *strictu sensu*, or possibly to gambling, reined in by propriety?

Ashton’s chapter on insurance, based primarily on the records of specific policies issued by Lloyd’s and on tales of some spectacular insurance frauds, can serve as a reminder of two kinds of connections between gambling and insurance. First, and most directly, Ashton details cases where underwriters actually serve as bookmakers, ‘insuring’ against events regarding which the policy holders have no direct stake and with which they have no direct contact. Colorful examples of this sort include the outcome of an election, the “dissolution of the present Parliament”; “two of the first Peers in Britain losing their heads”; the death or capture of Napoleon Bonaparte; and the life of the Queen during the months preceding the Queen’s Jubilee. Ashton considers wager policies such as these, including one on the “declaration of war with France or Spain” as “innocent” for the most part, though he does call for administrative interference in those policies with sinister political undertones, like those on the dissolution of parliament or on the lives of English peers, when the policies are underwritten by Scotsmen.<sup>2</sup> What is clear is that Ashton’s conception of “innocence” does not distance insurance from the taint of gambling, but merely puts it into a class of gambling that has no further negative effects. Ashton, it will be remembered, is an historian of gambling, and not of insurance. However, proponents of insurance could not rest with the characterization of insurance as innocent gambling, and needed to distinguish insurance from gambling more starkly.

The second connection between gambling and insurance raised by Ashton is the tendency of gambling to be exploited by organized fraud, and especially by what Karen Halttunen calls “confidence men.”<sup>3</sup> The danger identified by Ashton and explored by Halttunen goes far beyond the individual who is cheated out of money in a particular gamble: to the extent that gambling becomes a vocation, it presents an alternative to

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<sup>1</sup> John Ashton, *The History of Gambling in England* 275 (1898). He continues: “Yet a man would be considered culpable, or at the very least, negligent and indiscreet did he not insure.”

<sup>2</sup> Id. at 277-281.

<sup>3</sup> Karen Halttunen, *Confidence Men and Painted Women: A Study of Middle-class Culture in America, 1830-1870*, pp. 1-32 (1982).

productive industry, making the slow rewards of industrious exertion seem insipid and unattractive. Ashton's innocent wager policies and those policies tainted by fraud, like naked speculation on stocks or commodities, raise the specter of unproductive gain, of the man interested in getting something for nothing. Nineteenth century moralists linked fraud and capitalist speculation as forces that undermined the social fabric and mutual confidence that tied the community together.<sup>4</sup>

Advocates of insurance, therefore, viewed distinguishing insurance from gambling as a crucial stage in the legitimation and popularization of insurance, especially life insurance. While modern histories of insurance sometimes date the success of the distinction to the early nineteenth century,<sup>5</sup> Ashton, writing in 1898, assumed that insurance and gambling could not be distinguished, at least theoretically. And advocates of insurance, including the companies themselves, spent a great deal of energy on substantiating the distinction well into the twentieth century.<sup>6</sup> A telling example of such efforts is the history of the New York Life Insurance Company, commissioned by the company and published in 1930.<sup>7</sup> Early in the first chapter, the author describes the wagering policies prevalent in England in the eighteenth century and with them, the first life policy, issued on the life of one William Gibbons. He calls the Gibbons policy a "bald wager,"<sup>8</sup> distinguishing it from modern life insurance by pointing out that the laws of probability were scarcely taken into account, while conceding that the "mutual" or cooperative aspect of insurance did exist in the early policies. The author's advocacy of contemporary insurance practice takes the form of distinguishing insurance from betting by relying on the expertise and special knowledge employed by modern insurance companies. He elaborates:

Life insurance has ceased to be a mere bet as it was in the Gibbons case, and has become a scientific method of estimating the duration of life by a study and application of the law of probabilities and the laws of hygiene, sanitation and therapeutics. It is for this reason that in any successful and well regulated insurance company the Actuarial Department and the Medical Department are of

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<sup>4</sup> Id. at 17-22. See generally Herman Melville, *The Confidence-Man: His Masquerade* (Harrison Hayford et al., eds., Northwestern Univ. Press 1984) (1857).

<sup>5</sup> "By the second decade of the nineteenth century, the divorce between insurance and gambling was almost complete." Lorraine J. Daston, *The Domestication of Risk: Mathematical Probability and Insurance 1650-1830*, in 1 *The Probabilistic Revolution*, (Lorenz Kruger et. al., eds., 1987) at 253; "By the third decade of the nineteenth century, the divorce between insurance and gambling seemed final. Gambling was, to a large extent, outlawed, whereas insurance became a pillar of social order..." Reuven Brenner & Gabrielle A. Brenner, *Gambling, and Speculation: A Theory, a History, and a Future of Some Human Decisions* 106 (1990).

<sup>6</sup> Viviana A. Rotman Zelizer, *Morals and Markets: The Development of Life Insurance in the United States* 68-71 (1979).

<sup>7</sup> Lawrence F. Abbot, *The Story of NYLIC: A History of the Origin and Development of the New York Life Insurance Company from 1845 to 1929* (1930).

<sup>8</sup> Id. at 7-8.

very great importance. Both of these departments deal with what is known as the law of probability, a law which is the very essence of life insurance.<sup>9</sup>

In order to emphasize the scientific basis of insurance, the author then goes on to cite several encyclopedia articles on probability, assuring the reader that the entries are “the most terrifying and unintelligible exhibit of abstruse reasoning that perhaps can be found in popular literature,” comparing their calculations to hieroglyphics, and noting that “it would be impossible to quote them here without overtaxing the resources of the printer and the eyesight of the reader.”<sup>10</sup> But the point of the mild intimidation is actually to assure the reader that the equations too complex for her understanding are working for her benefit, under the professional, expert supervision of the company. After quoting a “simpler” article from a “popular encyclopedia,” the author, with a touch of wit, offers the definitive distinction between gambling and insurance: “Delightful reading! But without such reasoning, meaningless as it must be to the average layman, life insurance would be a mere Monte Carlo in which the roulette wheel would take the place of the actuary; with it, life insurance has become an exact science in which predictions can be made with all the certainty of mathematical calculations.”<sup>11</sup>

However, while insurance companies expended significant energy in distinguishing insurance from gambling in popular consciousness, they were also partially instrumental in keeping the connection between the two realms alive, at least as far as legal discourse was concerned, by claiming wager as a defense against payment on certain claims.<sup>12</sup> In other words, while the connection between gambling and insurance had at one time threatened the insurance industry directly by contaminating insurance, labeling it an illegitimate and destructive social force,<sup>13</sup> by the late nineteenth century, insurance companies regularly claimed that policies were in fact mere wagers in order to avoid payment. The legal doctrine that localized the discussion of gambling was the doctrine of insurable interest.

### The Doctrine of Insurable Interest

The doctrine of insurable interest is not an ancient common law doctrine, and in England, wager contracts were valid until well into the nineteenth century.<sup>14</sup> A leading

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<sup>9</sup> Id. at 9-10.

<sup>10</sup> Id. at 11.

<sup>11</sup> Id. at 12.

<sup>12</sup> This has been a common claim by insurance companies since the popularization of life insurance in the mid-nineteenth century, but the defense was not limited to life insurance, nor has it ceased to be a usable defense up to today. See, e.g., *Connecticut Mut. Life Ins. Co. v. Schaefer*, 94 U.S. 457 (1876) (insurance company claimed that divorced spouse had no insurable interest in the life of the insured, her former husband); *New York Life Ins. Co. v. Baum*, 700 F.2d 928 (5th Cir. 1983) (insurance company claimed that beneficiaries had no insurable interest in the life of the insured, and thus should not recover); *Fidelity Union Fire Ins. Co. v. Hicks*, 250 S.W. 1084 (Tex. App. 1923) (insurance company claimed hail insurance was void as wagering contract due to lack of insurable interest).

<sup>13</sup> Zelizer, *Morals and Markets*, 88.

<sup>14</sup> See 3 Samuel Williston, *The Law of Contracts* § 1667, § 1668 (1<sup>st</sup> ed. 1920) (footnotes omitted):

textbook on insurance law, treating the insurable interest doctrine alongside the principle of indemnity, defines the doctrine as “the concept that there must be some significant relationship between the insured and the person, the object, or the activity that is subject to the risks covered by the insurance arrangement.”<sup>15</sup> Without such a relationship or interest, any policy which may be issued would be void.<sup>16</sup> In his textbook treatment, Widiss acknowledges that the origins of the insurable interest doctrine are linked to the attempt to combat gambling, but by linking the doctrine closely to the indemnity principle, and especially by treating the doctrine’s origins in property insurance as identical to those in life insurance, he limits the importance of the hostility to gambling in the development of the doctrine. He writes: “It now seems evident that the principle of indemnity and the insurable interest doctrine rest – and undoubtedly have, in reality, always been at least partially predicated – on societal interests other than opposition to gambling.”<sup>17</sup>

In fact, however, while insurable interest doctrine is conceptually related in property insurance and life insurance, historically the doctrines developed separately. In property insurance, the indemnity principle and the insurable interest doctrine serve the same purposes, and are primarily directed toward combating moral hazard in the form of temptation to crime, or the tendency of the policy holder to destroy property in order to collect insurance.<sup>18</sup> Life insurance, on the other hand, is not an indemnity contract, and while the temptation to murder is a potential problem, the authorities in England who developed insurable interest doctrine were more concerned with the kind of wagering in lives and events that Ashton documented.<sup>19</sup> This type of insurance was pure wagering, and the authorities did not consider the danger of murder to be grave, because the bettors, common people, generally did not have any connection with or access to the people, generally heads of state or other public figures, whose lives they “insured” or rather bet upon. The wagering aspect of insurance had given the English courts the most trouble, and

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The mere fact that an agreement was a wager did not make it unenforceable or opposed to public policy according to the English common law. Statutes, however, restricted various forms of betting, and apart from such statutes wagers were held against public policy as matter of common law if the subject-matter of the bet was deemed to be obnoxious to the public welfare.

<sup>15</sup> Alan I. Widiss, *Insurance* 123 (1989).

<sup>16</sup> Franklin L. Best, Jr., “Defining Insurable Interests in Lives,” 22 *Tort & Ins. L.J.* 104 (1986).

<sup>17</sup> Widiss, *Insurance*, 124.

<sup>18</sup> This rationale relies on nineteenth century terminology; from a current economic perspective, moral hazard is described as the inefficient limiting of precautions against the occurrence of the insured event, which amounts to the same thing, the difference being one of degree. On the shifting meaning of “moral hazard” see Tom Baker, “On the Genealogy of Moral Hazard,” 75 *Texas L. Rev.* 237, 239-40 (1996).

<sup>19</sup> Ashton, *History of Gambling*, 279-281; see also Zelizer, *Morals and Market*, 71 (“The concept of insurable interest developed to guarantee the legitimate contractual motivation of life insurance. It was first introduced in England in 1774 as a legal weapon against the widespread wagering in lives.”).

it was primarily this problem that the Statute of George III, which founded insurable interest in life insurance, set out to remedy.<sup>20</sup>

### Insurable Interest of Assignees of Life Policies

It is an oft-heard and long standing charge that insurable interest doctrine is insufficiently clear. One insurance industry lawyer has complained the while “the insurer needs a single definition of ‘insurable interest’ that clearly distinguishes between those who have it and those who do not...the various states give insurers definitions that are contradictory and vague.”<sup>21</sup> Traditional difficulties in defining insurable interest include the question of whether the interest must be pecuniary, and the question of what kinds of family ties will be sufficient to raise a presumption of insurable interest. While it is generally conceded that everyone has an insurable interest in his or her own life, “The public policy against using life insurance policies as contracts of wager is so deeply ingrained into the fabric of insurance law that some courts have expressed a willingness to ignore the rule that one has an unlimited insurable interest in one’s own life.”<sup>22</sup> But the most significant complication in insurable interest doctrine arises in those cases where the insured assigns a policy to another.

The discussion of assignability of life insurance policies brings together two technically distinct legal questions. The first question is whether the assignee must have an insurable interest; and the second, what are the requirements of insurable interest, or what constitutes insurable interest. While these questions are technically distinct, the answers to them converge, since the underlying factual problem they address is the same. In order to understand the convergence of the legal questions, it is helpful to set out the factual context in which most assignments of insurance policies occur, and to keep in mind the dual purpose of insurable interest doctrine in life insurance: first, to limit the ability to use insurance as a means of wagering; and second, to limit moral hazard, or the temptation to murder the insured.

For a range of reasons, holders of life insurance policies often sought to assign the policies. This was especially so before 1880, because up until then the insurance companies would not buy back their policies, so any policy holder who could not continue paying the premiums faced an entire loss of equity. Faced with the injustice of “investors” losing everything they had paid in premiums, regulators pressured insurance companies to make arrangements to grant some surrender value for policies, especially if several years of premiums had been paid. However, even after 1880 when non-forfeiture laws were passed

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<sup>20</sup> Edwin W. Patterson, “Insurable Interest in Life,” 18 *Colum. L. Rev.* 381, 392-393 (1918); Widiss, *Insurance*, 125 (“The preamble to this statute stated that the legislation addressed ‘a mischievous kind of gaming’ in relation to ‘the making of insurances on lives, or other events, wherein the assured shall have no interest.’ Nothing was said of the destruction of the subject matter of insurance...”).

<sup>21</sup> Best, “Defining Insurable Interest in Lives” (at the time of the article’s publication, Best was an Associate General Counsel of Penn Mutual Life Insurance Company in Philadelphia, Pennsylvania).

<sup>22</sup> Johnny C. Parker, “Does Lack of an Insurable Interest Preclude an Insurance Agent from Taking an Absolute Assignment of his Client’s Life Policy?,” 31 *U. Rich. L. Rev.* 71, 79 (1997).

in several jurisdictions, surrender values were quite low, and policy holders often had a better chance of selling their policies for value, either to strangers or to acquaintances at varying levels of familiarity. In some cases, especially in England, the sale of policies resurrected old fears of widespread wagering in lives, with weekly insurance auctions where buyers in effect bet on the speedy death of the insured functioning as perhaps the most glaring reminder.<sup>23</sup>

The case-law of the period yields an array of fact situations, which can be arranged along a spectrum, from those where legitimacy of the transaction was widely assumed, and leading to those where it was widely rejected. While it was early accepted that a person had an insurable interest in his or her own life, the question of whether a person could name a beneficiary who had no insurable interest generated a fair amount of litigation. The next stage of complication involved a situation in which the insured procured the policy and named a beneficiary who had no insurable interest, but when the insured became unable to pay the premiums, the beneficiary paid the premiums to keep the policy in force. Closely related to this scenario were cases where the insured assigned the policy to one having no insurable interest but who paid the premiums, with the major difference being that in this case, the assignee would then have control of the policy, including the power to sell it to a third party. Particularly difficult cases, including the influential case of *Warnock v. Davis*,<sup>24</sup> arose when a potential insured agreed before procuring the policy that the policy would be assigned immediately upon purchase. Finally, there were cases where a person without insurable interest initiated the insurance, attempting to take out a policy on another without having the necessary connection to the potential insured. Thus, the spectrum of cases includes five basic fact situations, which for the sake of clarity may be presented schematically:<sup>25</sup>

1. A procures policy and names B, who has no insurable interest, the beneficiary.
2. A procures a policy and B, who is the beneficiary, pays the premiums thereon.
3. A procures a policy, eventually assigning it to B.
4. A procures the policy with the prior intention of assigning it to B.
5. B procures the policy on A's life.

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<sup>23</sup> See Zelizer, *Morals and Market*, 69-70. Zelizer adds: "Another form of gambling with life, known as 'graveyard insurance,' briefly flourished in the United States in the early 1880's with speculators insuring the lives of old people, preferably paupers who were likely to die soon."

<sup>24</sup> 104 U.S. 775 (1881).

<sup>25</sup> In these examples, it is always the life of A that is insured; thus, A is the *Cestui Que Vie*, and B always lacks an insurable interest in the life of A. In addition, it was not always the insurance company that raised the issue of insurable interest; often, the representatives of the estate of the insured raised the claim. Insurers often admitted liability, deposited the proceeds with the court and filed bills of interpleader, so that the court would only have to decide between parties claiming rights to the policy.

At the extremes of this spectrum, the law was able to generate relatively clear (though not unanimous) solutions to the problem of wagering in lives.<sup>26</sup> As far as the first situation was concerned, since the insured procured the policy and continued to make the premium payments, there was little danger that the transaction was a cover for wagering, because the party who stood to gain was completely passive. The insured was in effect investing money to be given to the beneficiary after the former's death. While insured people often felt moral obligation toward those they named beneficiaries, there was normally nothing required by law on this point to validate the policies. Thus, in almost all cases,<sup>27</sup> an insured could make a party with no insurable interest a beneficiary, just as she could give that party a gift.<sup>28</sup> The final situation of the five described above – where the buyer of a policy has no connection with the insured – raises the specter of gambling in the most direct way, so the requirement of insurable interest has been applied in its most straightforward form. In other words, where a policy is procured by a party other than the insured, the moving party must have an insurable interest for the policy to be valid.<sup>29</sup>

In the three intermediate categories, the law vacillated between two conflicting policy objectives, with different jurisdictions reaching varying results. A look at some typical cases helps view the problem, and the courts' attempts to impose a solution based on sound policy, more concretely.

In *Rylander v. Allen*, the administratrix of Allen's estate brought an action against the Travelers' Insurance Company and Mrs. Rylander to recover the amount of an insurance policy issued by the company on Allen's life.<sup>30</sup> Allen, eight years before his death, procured an insurance policy on his life, payable to his estate. Four months later, he assigned the policy to Rylander, who had no interest in the continuance of his life, and who thereafter paid the premiums. The administratrix sued, claiming that Rylander had intentionally entered into a speculation on Allen's life. While the details of the transaction are not fully elaborated in the case, it appears that Rylander paid Allen "a valuable

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<sup>26</sup> I will for the most part disregard the other half of the purpose of insurable interest doctrine, i.e. the prevention of the temptation to murder the insured. For an interesting treatment of that issue, see Baker, "Genealogy of Moral Hazard."

<sup>27</sup> An apparent exception to this rule exists in Texas, where the courts have stated that "[i]n order to make a valid contract upon the life of one person for the benefit of another the beneficiary must have an interest in the life insured." *Goldbaum v. Blum*, 15 S.W. 564, 565 (Tex. 1891). However, in that case, and others cited for the same proposition, the beneficiaries paid all the premiums, and were instrumental in initiating the policy, so the statement was actually not controlling. For a recent case, see *Stillwagoner v. Travelers Ins. Co.*, 979 S.W.2d 354 (Tex. App. 1998) (unbeknownst to employee, employer purchased life insurance policy on employee's life, naming employer beneficiary).

<sup>28</sup> "If the cestui also pays the premiums, the transaction is an investment-gift – that is, a gift to the beneficiary of the investment made by the cestui. While gifts do not perform any useful function in trade or commerce, the courts recognize the validity of such policies as incidental to freedom of gift." Patterson, "Insurable Interest in Life," 397 (citation omitted).

<sup>29</sup> Parker, "Lack of Insurable Interest," 76.

<sup>30</sup> 53 S.E. 1032 (Ga. 1906). Faced with conflicting interests in payment, the company deposited payment with the court, leaving the only conflict between the assignee of the policy and the estate.

consideration” for the assignment of the policy. After summarily disposing of the moral hazard problem,<sup>31</sup> the court goes on to compare the beneficiary with no insurable interest to an assignee, summing up its position by saying,

If, where one who has in good faith procured a policy of insurance upon his own life and kept it in force for a time, and thereafter has had a new policy issued in lieu thereof, payable to one who has no insurable interest in the life insured, the policy is not void as a wagering policy, although such beneficiary thereafter keeps the policy alive by paying the premiums or assessments falling due thereon, it must necessarily follow, we think, that if one in good faith procures a policy of insurance upon his own life, an assignment of the policy made by him will be valid, if not done by way of cover for a wager policy, though the assignee has no insurable interest in the life of the insured.<sup>32</sup>

The rest of the opinion is devoted to an attempt to divine what, if any, actions would amount to an indication that the policy was in fact a cover for a wager policy, with the court eventually speculating that evidence of preconceived intent to assign the policy would tend to invalidate the policy. In the absence of such evidence, or even of direct allegations to that effect, the court concludes:

[T]he assignment is said to be a gambling transaction, a mere bet or wager upon the chances of human life. But the wager was made when the policy was effected, and has the sanction of the law. The assignment simply transfers the policy, as any other legal chose in action may be transferred, from the holder to a bona fide purchaser. It is true, there is an element of chance and uncertainty in the transaction, but so is there when a man takes a transfer of an annuity, or buys a life estate, or an estate in remainder after a life estate. There is in all these cases a speculation upon the chances of human life. But the transaction has never been held to be void on that account.<sup>33</sup>

There are several noteworthy elements to the opinion. The first may be gleaned from the tone of this particular passage, which is indicative of the tone of the opinion as a whole. There is a marked air of resignation, as if the court feels compelled, with at least a hint of reluctance if not sadness, to approve transactions of insurance. Thus, the wagering element of the particular transaction, *i.e.*, the assignment, is generalized and projected onto the insurance arrangement itself: “But the wager was made when the policy was effected, and has the sanction of the law.” The force of the argument that the assignment is a wager is diffused, since an initial wager, that of the insurance policy itself, has (always) already been sanctioned by law. Insurance, on this view, is still a wager, but a wager that the law

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<sup>31</sup> The court deals with this problem simply, by relying on the rule that a beneficiary of a policy on which the insured pays the premiums is entitled to recover. Comparing the beneficiary who doesn’t pay the premiums to one who does, the court says that the temptation to hasten the demise of the insured is equal in both cases, and since it does not invalidate the policy in the first case, it should not do so in the second. *Id.* at 1034.

<sup>32</sup> *Id.*

<sup>33</sup> *Id.* at 1037 (quoting *Clark v. Allen*, 11 R.I. 439, 443-44 (1877)).

sanctions. In addition, the law's approval of the insurance wager does not occur in a vacuum, but rather in the context of other transactions involving "chance and uncertainty" and even "speculation upon the chances of human life" such as annuities and life estates.

On the one hand, then, the court will not condone and validate a transaction that is a mere cover for a wager contract. And yet, on the other hand, the court admits that an insurance policy, like other widely accepted contracts, *e.g.* transfers of annuities or life estates, are on some quite basic level wagers of a particular sort: speculations on human life. What might appear as a contradiction within the court's reasoning is actually a two-pronged strategy of containment, containing the practice of wagering on the one hand, and the legal argumentation regarding transfers of property on the other.

The practice of wagering is controlled by the court's reserving its power to invalidate contracts made with the express intention of circumventing the prohibition on gambling. But this power is no longer exercised by applying a simple label of wager; instead, the court shows itself willing to delve deep into the facts in order to distinguish the good wager from the bad wager. By the same token, the court limits the power of a legal argument based simply on labeling a particular transaction a wager. Where the plaintiff attempts to rely on the characterization of the assignment of the policy as a wager, the court pokes through this characterization by taking it a step further, showing that the argument is applicable to insurance generally, as well as to transfers of other property, none of which are traditionally susceptible to the claim that they are illegal wagers. The court thus recognizes the difficulty of upholding an analytical distinction between transactions that can be characterized as wagers and those that cannot, and abandoning that distinction (without saying so overtly), takes the affirmative step and responsibility of distinguishing between legitimate and illegitimate transactions. The court's new distinction is not based on the label of wager, but rather on the question of whether the practice underlying the transaction has anti-social effects.

What then, of the underlying practice? Why does the court see a need to protect the transaction in question, this assignment of an insurance policy? Again, the key can be seen in the court's use, on its own initiative, of an expanded analogy. "The assignment simply transfers the policy, *as any other legal chose in action may be transferred*, from the holder to a bone fide purchaser."<sup>34</sup> The court here sees itself on the pivot of a certain moment in the history of contract doctrine, and it opts to leave the past behind by adopting "the more modern and rational rule that any person has a right to procure an insurance on his own life, and to assign it to another, provided it be not done by way of cover for a wager policy."<sup>35</sup> Positioning itself on the progressive side of its own historical narrative, the court recalls that "A life policy is a chose in action, a species of property, which the holder may have perfectly good and innocent reasons for wishing to dispose of. He should be allowed to do so unless the law clearly forbids it."<sup>36</sup> This particular historical narrative is

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<sup>34</sup> *Id.* at 1037 (emphasis added).

<sup>35</sup> *Id.* at 1036.

<sup>36</sup> *Id.* at 1037.

one of the expansion of contract by making the rights defined by the contract transferable, or in other words, making contractual rights into a form of property.<sup>37</sup> The question of what is at stake in such an expansion of contract will arise again.

Not all courts at this time however, positioned themselves similarly regarding assignment of insurance policies, nor did they feel resigned to sanctioning some form of gambling. One example is *Manhattan Life Ins. Co. v. Cohen*.<sup>38</sup> In that case, Jacob Cohen took out \$7,500 (in two policies) of life insurance in Texas in 1893. Before his death in October 1907, Cohen made two uses of the policy for commercial purposes. First, he obtained a loan of \$1,750 from the insurance company, using the policy as collateral, and in fact with the understanding that payment would be taken from the value of the policy payment. Second, a few months before his death, Cohen assigned the policy to J.H. Hilsman, with whom he was engaged in (of all things) speculative transactions in cotton futures, which the court characterizes as gaming contracts in which the parties did not contemplate that there would be actual delivery.<sup>39</sup> The court notes that Hilsman, the assignee, paid Cohen \$460 for his equity in the policies, but significantly, it attributes greater importance to the nature of their business relations than to the specifics of the transaction of assignment. Because Hilsman and the insurance company claimed that Georgia, rather than Texas law governed the transaction, the court was forced to deal with the issue of validity of assignment comparatively:

[W]here the policy is taken out by the insured himself for his own benefit, there is an irreconcilable conflict in the authorities upon the question as to whether he may make a valid assignment of it to one who has no insurable interest in the life of the assured. This conflict grows out of the general rule above stated. In some jurisdictions it is held that the same principle of public policy which inhibits one from insuring the life of a person in whom he has no insurable interest forbids him from taking an assignment of a policy taken out by the insured for his own benefit. In others it is held that such an assignment is not affected by public policy, and that it is of the same validity as the assignment of any other chattel.<sup>40</sup>

This presentation of the conflict of authorities is helpful in delineating the central point of uncertainty in the law, but it relies, in its final sentence, on a subtle distortion. By claiming that the jurisdictions allowing assignment ignore public policy, the court implies that the opposing rule is an unthinking or even irrational clinging to a technical rule by

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<sup>37</sup> This is a narrative of “expansion” because at early common law, choses in action were not assignable. Assignability grew with the rise in importance of negotiable paper, and is in some ways a mirror image in this aspect of the rise of a commercial law of contract. See 1 Williston *Law of Contracts*, §§ 404-406, 410, 414. See also, Morton J. Horwitz, *The Transformation of American Law, 1780-1860*, pp. 212-226 (1977).

<sup>38</sup> 139 S.W. 51 (Tex. Civ. App. 1911).

<sup>39</sup> *Id.* at 52.

<sup>40</sup> *Id.* at 55; regarding which jurisdictions fall into which camp, the court continues: “The courts of Alabama, Kansas, Kentucky, Missouri, Pennsylvania, and Virginia hold with Texas that such assignments are invalid, on the ground that they are opposed to public policy.” *Id.* at 56.

which choses in action are assignable.<sup>41</sup> In fact, as will later be shown, both sides in the conflict over assignability rely primarily on public policy to justify the rule they adopt.

There were two closely related reasons for the reliance on public policy in this context. First, as briefly mentioned above, the doctrine of assignability of choses in action, while often referred to in these cases, was not an ancient doctrine, and its validity and especially its borders were far from well-established. Writing on the difficulty of establishing negotiability for commercial paper, Morton Horwitz comments that “it ran completely contrary to the ancient common law hostility to assignment.”<sup>42</sup> Full negotiability of promissory notes, which had the advantage of clear intent of the parties to establish their negotiability, gradually emerged in the United States over the course of the nineteenth century, and was only fully established in 1879.<sup>43</sup> Assignability of choses in action rested on the same principles, but was not supported by the same clear commercial interests Horwitz identifies as favoring negotiability of promissory notes, nor by the long tradition of enforcement among merchants. Thus, the formal rule of assignability carried little force as a counter weight to a convincing argument from public policy. The second reason that the courts resorted primarily to public policy justifications for assignability was that widespread assignment of insurance policies was a relatively recent phenomenon, and in the absence of a well-established formal rule, public policy provided an important rhetorical repertoire to explain how the validation of assignments led to just outcomes in the cases.

Before expanding on this point by looking at a few more cases, I will return briefly to *Manhattan Life v. Cohen*,<sup>44</sup> to examine the policy considerations it mentions as controlling the case. The court concentrates in its opinion on the nature of the business relationship between the insured and the assignee that led up to the assignment, diminishing the importance of the consideration paid to the insured, and ignoring the question of whether in addition to the \$460 paid directly to the insured, the consideration also included cancellation of an additional debt between them. Since there is no indication that Cohen was nearing insolvency or was in any way coerced into the assignment, and since he had paid premiums on the policy for fourteen years, it is not unreasonable to surmise that an additional debt between Cohen and Hilsman was settled through the assignment. But the court is not interested in settling the case on the basis of the equities between Cohen and Hilsman, since in its view their entire relationship is tainted by gambling. At one point,

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<sup>41</sup> In technical terms, the court overstates the case made by those jurisdictions that allow assignment, in that they all view the insurance policy as a chose in action, and not as a chattel. Although this is a minor and technical distinction (which the court in a later paragraph abandons), in this passage it serves to expand the opposing claim, making it an easier target to combat (for instance, if insurance policies were assignable as chattels, rather than choses in action, defenses by the insurance company against the party procuring the insurance, such as fraud, would not be available against the assignee – a clearly undesirable result). On the difference between assignment of chattels and choses in action, see 1 Williston, *Law of Contracts*, § 404.

<sup>42</sup> Horwitz, *Transformation of American Law*, 212.

<sup>43</sup> See *id.* at 212-226.

<sup>44</sup> 139 S.W. 51 (Tex. Ct. Civ. App. 1911).

adopting the estate's proposition of which rule should govern, the court says, "The consideration for the assignment of these policies having been advanced by Hilsman for the express purpose of assisting the insured to participate in a gambling transaction with said Hilsman [,] the consideration was void in law and the attempted assignment of the policies for that reason alone vested no right in Hilsman to either of the policies or the proceeds thereof."<sup>45</sup> While the conflict of laws analysis maintains a balanced judicious tone, when faced with Hilsman's claim in its most direct form, the court's rhetorical style bursts into a condemnation of the pure immorality of gambling, culminating in a statement of biblical wrath:

Had [Hilsman] sought to enforce [the policy] through the medium of the courts, he would have been met by the inquiry, 'What right have you to the money due on these policies?' His only true answer would have been, 'I own them under an assignment from the beneficiary, which the law denounces as illegal and pronounces as void.' *Then would the court say unto him, 'Depart from me, ye wicked; I know you not.'*

It would be preposterous to hold that that which is void as against public policy can be validated by a contract which is also void as against public policy.<sup>46</sup>

With or without the unattributed allusion to the gospel,<sup>47</sup> it is clear that the public policy at stake is a moral crusade against the evils of gambling. And in the relationship between Cohen and Hilsman, the court finds two of the dominant modes of commercial behavior often associated with gambling: commodities trading and wagering in lives by assigning insurance policies. The presence of both in one fact situation reinforces the court's crusading energy, allowing it to hold that the use of one mode of gambling to validate another would be "preposterous".<sup>48</sup>

While all courts paid it lip service, those in the majority of jurisdictions seem to have seen the anti-gambling crusade as a less compelling justification for invalidating the assignments of insurance policies. One concise articulation of the policy justification for allowing the assignment of life insurance policies is the opinion of Justice Holmes in *Grigsby v. Russel*.<sup>49</sup> In that case, the insured, in need of money for a surgical operation, sold the policy to Dr. Grigsby for \$100. He had up to that time paid two premiums, and was unable to pay the third. Grigsby, who had no insurable interest in the life of the insured, paid the rest of the premiums, and upon the insured's death, claimed the proceeds

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<sup>45</sup> Id. at 58.

<sup>46</sup> Id. at 58 (emphasis added).

<sup>47</sup> "And then will I profess unto them, I never knew you: depart from me, ye that work iniquity." Matthew 7:23.

<sup>48</sup> The court's attention to the "gambling" relationship, which takes for granted that commodities futures trading is a form of wagering, allows it to circumvent what might be a deeper problem with assignments, which is the problem of the adequacy of consideration.

<sup>49</sup> 222 U.S. 149 (1911).

of the policy. The administrators of the insured's estate also claimed the proceeds of the policy, saying that the assignment was only valid to the extent of the money actually given for the policy and the premiums subsequently paid.<sup>50</sup> The district court ruled for Grigsby, and the circuit court reversed. Holmes, after laying out the facts, summarily presents the legal claim of the estate:

[T]he ground suggested for denying the validity of an assignment to a person having no interest in the life insured is the public policy that refuses to allow insurance to be taken out by such persons in the first place. A contract of insurance upon a life in which the insured has no interest is a pure wager that gives the insured a sinister counter interest in having the life come to an end.<sup>51</sup>

While Holmes here articulates both the hostility to gambling and the problem of moral hazard as basic policy considerations regarding life insurance, he notes that the gambling aspect is historically more central to insurable interest doctrine. At the same time, he limits its generality, saying that the law does not object to the very idea of a party to a contract benefiting from the other party's death: "The law has no universal cynic fear of the temptation opened by a pecuniary benefit accruing upon a death. It shows no prejudice against remainders after life estates... Indeed, the ground of the objection to life insurance without interest in the earlier English cases was not the temptation to murder, but the fact that such wagers came to be regarded as a mischievous kind of gaming."<sup>52</sup> And yet, while conceding that opposition to gambling was the main impetus for the development of insurable interest doctrine, Holmes does not view it as important, dismissing the problem almost without real consideration, saying that, "when the question rises upon an assignment, it is assumed that the objection to the insurance as a wager is out of the case."<sup>53</sup> On the other hand, Holmes articulates concisely the public policy reason for allowing assignment of policies, almost nonchalantly reminding the reader that, "life insurance has become in our days one of the best recognized forms of investment and self-compelled saving. So far as reasonable safety permits, it is desirable to give to life policies the ordinary characteristics of property."<sup>54</sup>

One of the reasons that Holmes could allow himself such telegraphic justification is that the position he espoused had been articulated early on, even when insurance was not a popular means of saving. The position goes back at least as far as the 1855 case of *St. John v. American Mutual Life Insurance Co.*, where the court said that "without the right to assign, insurances on lives lose half their usefulness."<sup>55</sup> A more complete account of the policy argument behind allowing assignments of life policies is given in *Steinback v.*

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<sup>50</sup> Id. at 154.

<sup>51</sup> Id.

<sup>52</sup> Id. at 155-156, citing Stat. 14 George III., chap. 48.

<sup>53</sup> Id. at 155.

<sup>54</sup> Id. at 156.

<sup>55</sup> 13 N.Y. 31, 39 (1855).

*Diepenbrock*,<sup>56</sup> where the court notes that sound public policy requires that an insured be permitted to treat the policy as a chose in action and “go to the best market he can find, either to sell it or borrow money on it,” lamenting that an insured without this power would be “limited in his choice of a purchaser to the party having an interest in the continuance of [his] life.”<sup>57</sup> In that case, the insured had held the policy for about five years, and its surrender value was only \$485. The court explains the insured’s predicament:

He was pressed for money, and finally sold the policy to the defendant...for \$600, or something like \$115 more than he would have received by the surrender of the policy to the company. He had paid a much larger sum in premiums, – something over \$2,000, – and there seems to be no good reason why a person owning such a policy, and obliged to sell it, should not be permitted to get back as much as possible of the money that he has paid out for insurance...There is no good reason for saying that an insured person should not have the right, whenever his necessities press him, because of a failing condition of health that assures a speedy death, to realize on his policy, and obtain for it something like a fair price, which may, perhaps, be almost equal to its face value.<sup>58</sup>

Thus, the policy underlying the allowance of assignments is the protection of the insured, by maintaining the liquidity of his or her investment. In the long run, then, allowing assignments rests on the same footing as encouraging insurance as a mode of savings, since people will be encouraged to insure if their investment (in the form of premiums) can be recovered before death.

The question remains, for those courts that take the danger of gambling in lives seriously, of how to protect legitimate insurance without protecting gamblers. The court in *Steinback* takes great pains to establish a means of distinguishing between those policies that are legitimate insurances, which should be granted whatever market value the insured can procure, and those policies which are a cover for wager transactions. The means suggested by the court is an examination of the intent of the parties:<sup>59</sup> “The intention of the parties procuring the policy would determine its character, which the courts would unhesitatingly declare in accordance with the facts, reading the policy and the assignment

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<sup>56</sup> 158 N.Y. 24 (1899).

<sup>57</sup> *Id.* at 31.

<sup>58</sup> *Id.* at 33.

<sup>59</sup> Recall that this was precisely the maneuver courts employed in dealing with the problem of wagering in commodities. This is still the modern view:

The standard for determining whether the presumption of validity [of assignment] has been successfully rebutted is the ‘intentions of the parties’ test. Pursuant to this standard, courts examine a number of factors in the quest to determine whether the assignment was a subterfuge for a wagering contract. However, no single factor alone has been identified as controlling on the issue. Each factor must be considered in combination with the underlying facts and circumstances of the case.

Parker, “Lack of Insurable Interest,” 87-88.

together, as forming part of one transaction.”<sup>60</sup> In order to gauge the parties’ intentions, “all the facts and circumstances may be proved, and if it then appear that the parties intended by the contract to enable a third and uninterested party to speculate upon the life of another, the court will declare such a contract invalid, not because of the assignment, but in spite of it.”<sup>61</sup> And, as far as the *Steinback* court is concerned, the investigation of the intention of the parties should yield an answer to the question of whether the parties acted in good faith:

The materiality of the value of the interest has relation to the question of whether the policy is taken out in good faith, and not as a gambling transaction. If it be taken out in good faith, then a sound public policy would seem to require that the payee should be permitted to treat it as he may any other chose in action...<sup>62</sup>

The *Steinback* court was one of many that announced good faith as the key to the validity of assignment, and the Supreme Court’s attitude was typical: “The essential thing is, that the policy shall be obtained in good faith, and not for the purpose of speculating upon the hazard of a life in which the insured has no interest.”<sup>63</sup> Other courts expanded, or specified the role of good faith in the context of assignment:

Another reason sometimes assigned for holding such assignments illegal is that an assignee having no insurable interest is in the position of one who, in the first instance, takes out a wager policy. But we think not. If an insurable interest exists in the beneficiary at the time the policy is issued, and it is taken out in good faith, the object and purpose of the rule against wager policies would seem to have been sufficiently attained.<sup>64</sup>

Indeed, for those courts interested in allowing the assignment of insurance policies, “good faith” became something of a talisman,<sup>65</sup> with one contemporary writer claiming that good faith, or in his parlance, *bona fides*, was “the logical test of the propriety, and hence of the validity” of insurance contracts.<sup>66</sup>

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<sup>60</sup> *Steinback*, 158 N.Y., at 31.

<sup>61</sup> *Id.* at 32.

<sup>62</sup> *Id.* at 30-31.

<sup>63</sup> *Connecticut Mut. Life Ins. Co. v. Schaefer*, 94 U.S. 457, 460 (1876).

<sup>64</sup> *Chamberlain v. Butler*, 86 N.W. 481, 482 (Neb. 1901).

<sup>65</sup> For representative rhetoric regarding the adoption of the good faith test, see, *Finnie v. Walker*, 257 F. 698, 700 (2d Cir. 1919) (“A life insurance policy taken out in good faith by the insured, with no idea of assigning it, can afterwards, in good faith, and for a valuable consideration, be sold and assigned to one who has no insurable interest in the life...”). For additional cases adopting the good faith test, see, e.g., *Grigsby v. Russell*, 222 U.S. 149, 156 (1911); *Bankers’ Reserve Life Co. v. Matthews*, 39 F.2d 528, 529 (8<sup>th</sup> Cir. 1930); *Mechanics’ Nat. Bank v. Comins*, 55 A. 191, 193 (N.H. 1903); *Brett v. Warnick*, 75 P. 1061, 1064 (Or. 1904).

<sup>66</sup> William Reynolds Vance, *Handbook of the Law of Insurance* 103 (1904); see also Patterson, “Insurable Interest in Life,” 403-06.

However, the widespread use of the term “good faith” does not constitute a guarantee that all courts share an understanding of what “good faith” entails, nor even that the term has discernible content at all. A number of examples show the difficulty in establishing a fixed meaning for “good faith” in this context. In *Banker’s Reserve Life Co. v. Matthews*, the court adopted the good faith test, saying, “In short, the test is the good faith in taking out the policy for the benefit of one having an insurable interest.”<sup>67</sup> The facts of the case, however, suggest a difficulty. The insured procured life insurance (in two policies of \$5,000 each), assigning seven tenths of the value to Dr. Matthews and his wife, who was the insured’s cousin. In return, Matthews agreed to pay all the premiums on the policies. The policies were taken out with the intention that they be assigned to Matthews, and the court, after an in depth review of the circumstances surrounding the transactions, validated the assignment.<sup>68</sup> But in many of the cases where assignments are made long after procuring the insurance, the courts raise the hypothetical situation of an assignment agreement made at the time of purchase as the very paradigm of the lack of good faith.<sup>69</sup> In fact, the case most often cited for the invalidation of assignment, *Warnock v. Davis*, had an almost identical fact pattern to the *Matthews* case.<sup>70</sup> On the other hand, in *Finnie v. Walker*, the court voided assignments of a series of policies, some of which were made over a year after the policies had been procured.<sup>71</sup> Thus, the timing of the assignment is not a reliable objective test for “good faith.”

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<sup>67</sup> 39 F.2d at 529.

<sup>68</sup> Similarly, in another case, the Supreme Court of Arkansas validated an assignment, even though the policy was procured with the intention of assigning it to one who had no insurable interest. See *Prudential Ins. Co. of America v. Williams*, 168 S.W. 1114 (Ark. 1914). In that case, the insured procured the policy with the intention of assigning it to a party who died before the assignment could be executed, and then the insured assigned it to a third party, whose right to the proceeds of the policy was upheld.

<sup>69</sup> See, e.g., *Steinback v. Diepenbrock*, 158 N.Y. 24, 31 (1899):

The insured, instead of taking out a policy payable to a person having no insurable interest in his life, can take it out to himself, and at once assign it to such person. But such an attempt would not prove successful, for a policy issued and assigned, under such circumstances, would be none the less a wagering policy because of the form of it.

For additional cases where courts raise the hypothetical case of assignment at the time of procuring the policy, see, e.g., *Grigsby v. Russel*, 222 U.S. 149, 156 (1911); *Chamberlain v. Butler*, 86 N.W. 481, 483 (Neb. 1901); *Rylander v. Allen*, 53 S.E. 1032, 1037 (Ga. 1906):

Of course, one cannot do indirectly what the law prohibits him from doing directly, and as it is unlawful for a person to effect insurance upon the life of another in the continuance of whose life he has no interest, an invasion of this rule by the issue of a policy to one who has an insurable interest, and its immediate assignment, pursuant to a preconceived intent, to one without such interest, who undertakes to pay the premiums for his chance of profit upon his investment, is ineffective, and such assignment is void.

<sup>70</sup> *Warnock v. Davis*, 104 U.S. 775 (1881). The only real difference was that in *Warnock*, nine tenths of the insurance was assigned to a mutual agency of which the insured was a member, rather than, as in *Matthews*, to his cousin.

<sup>71</sup> *Finnie v. Walker*, 257 F. 698, 701 (2d Cir. 1919).

Even the cases that invalidate assignments do not offer a conclusive understanding of what “good faith” includes. For instance, in both *Warnock v. Davis* and *McRae v. Warmack*, it was held that the assignment was not of the “fraudulent kind with respect to which the courts regard parties as alike culpable and refuse to interfere with the results of their action. No fraud or deception upon any one was designed by the agreement, nor did its execution involve moral turpitude.”<sup>72</sup> Thus, on the one hand, one need not have an evil intent or be guilty of “moral turpitude” to run afoul of the prohibition on assignments that amount to wagers; on the other hand, there is no clear objective test, for example the time of assignment, through which a lack of good faith can be definitively determined. Noting the difficulty in administering the test of “good faith,” one contemporary critic lamented that it had become a “touchstone for identifying wagering contracts of insurance”:

Does ‘good faith’ mean that the parties must be free from any consciousness of wrong-doing in procuring the policy? In *Warnock v. Davis, supra*, and *McRae v. Warmack, supra*, the court distinctly said that the transaction did not involve any ‘moral turpitude’. Does ‘good faith’ mean that the purpose is not to evade the law against wagering? If so, what is the law, and as a corollary, when is it evaded? The ‘good faith test’ answers neither of these questions. Or, to put it another way, is the absence of the intent to make a ‘wager’, ‘good faith’? Then what is a ‘wager’, and how are the parties to know when they are making one, unless each man is the sole judge of his own ‘good faith’? It is submitted that the law’s standard of harmfulness is objective, not subjective, and that ‘good faith’ is not only futilely ambiguous, but also positively misleading... The phrase ‘good faith’ is valueless as a universal test of insurable interest.<sup>73</sup>

Good faith is introduced in this context as a mechanism to solve the difficulty of distinguishing between wagers and legitimate insurance when the form of the transactions is identical. But the displacement is a failure: determining whether a contract is entered into in good faith turns out to be as difficult, and as dependent on social consequences and cultural values as the distinction between wagers and insurance was in the first place.

The courts’ treatment of commodities and insurance cases reveals the following parallel structure. In both types of cases, the courts take a stand in limiting freedom of contract by distinguishing between an approved and a forbidden contractual form, *i.e.*, between legitimate and illegitimate transactions, between permitted contracts and gambling. They discover that analytically, the forms are indistinguishable, and in response, they formulate a second set of distinguishing maneuvers, invoking intent and good faith. The problem of fixing a meaning for those terms however, reenacts the anxieties that generated the initial distinction between the approved and prohibited contracts. Avenues for overcoming those anxieties are the focus of the last chapter in this part.

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<sup>72</sup> *Warnock v. Davis*, 104 U.S. 775, 781 (1881); *McRae v. Warmack*, 135 S.W. 807, 811 (Ark. 1911).

<sup>73</sup> Patterson, “Insurable Interest in Life,” 404-05.

## 8

## ACQUISITIVE INDIVIDUALITY VERSUS COMMUNAL EFFICIENCY: CONFLICTING POLICIES AND THE LOVE/HATE RELATIONSHIP WITH RISK

The analytical emptiness of the good faith standard as a tool for distinguishing legitimate from illegitimate contracts exposes a gap in the law. As in the case of the intent of the parties to commodities futures contracts, the gap is filled, not with a technical legal test, but with a conflict among policies. On the one hand, there is the policy of limiting wagers. It bears emphasis that the law is not interested in eradicating wagers, since elements of risk exist in the most legitimate transactions and the law has no way of definitively distinguishing wagers from legitimate contracts. Rather, the policy in its most defensible form is the more modest one of limiting wagers in such a way that gambling as a vocation does not become attractive. Thus, the limitation of the capacity to wager is positioned within a wider goal of the law and of emerging capitalistic culture generally, which is to foster acquisitive individuality. The chief objection to the wagering contract is that it leads to unearned gain. And, while the law does not attempt to eliminate every unearned gain, it does attempt to limit the harmful social consequences of a mechanism that allows people to get something for nothing. Edwin Patterson, writing in 1918 and defending the limitation of wagers through insurance, explains why the law must combat a vocation of wagering, while wagers that do not amount to a vocation will not have the same harmful consequences:

Vaguely, a sense of antagonism is aroused in a community of workers against persons who obtain a means of livelihood without participating in the machinery of social or economic production and distribution – in short, against ‘social slackers’. More specifically, unearned gains lead to idleness, and the wagerer becomes a social parasite. Useful business and industry are thereby discouraged. On the moral side, idleness leads to vice; and the impoverishment of the loser entails misery, and, in consequence, crime.<sup>160</sup>

Similarly, modern commentators have noted that gambling, in its various forms and especially when it offered itself as a vocation, stood in defiance of an ethic of industry deemed necessary to support a productive labor force. By holding out the promise of instant wealth, gambling undermined individual motivation to accumulate money gradually through employment.<sup>161</sup>

On the other side of the gap exposed by the lack of a technical legal mechanism to distinguish gambling from legitimate contract stood an ideal of communal efficiency. In

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<sup>160</sup> Edwin W. Patterson, “Insurable Interest in Life,” 18 *Colum. L. Rev.* 381, 386 (1918) (footnotes omitted).

<sup>161</sup> Viviana A. Rotman Zelizer, *Morals and Markets: The Development of Life Insurance in the United States* 88 (1979); See also, Karen Halttunen, *Confidence Men and Painted Women: A Study of Middle-class Culture in America, 1830-1870*, p. 17 (1982); Ann Fabian, *Card Sharps, Dream Books, and Bucket Shops: Gambling in 19<sup>th</sup> Century America* 61 (1990); Vicki Abt, et. al., *The Business of Risk: Commercial Gambling in America* 208 (1986).

the simplest terms, “Life insurance emerged as the most efficient secular risk-bearing institution to handle the economic hazards of death through cooperative self-help.”<sup>162</sup> But the principle of efficient risk bearing was hardly limited to life insurance, and the policy of efficient risk management bears further elaboration, especially in its relation to both insurance and speculation in commodities futures. Commentators who tried to legitimize various forms of economic activity that resembled gambling repeatedly resorted to the vocabulary of professionalism and specialization. New York Life’s commissioned history, referred to earlier, is a prime example, where the author distinguishes modern life insurance from the older, wagering form, by claiming that insurance “has become an exact science in which predictions can be made with all the certainty of mathematical calculations.”<sup>163</sup> Other expressions of the policy were less vulgar and more detailed.

Early in the century, economists elaborated the relationship between increasing efficiency and encouraging speculation, laying the basis for the market consciousness that to a great extent still governs modern conceptions of economic activity. In *Risk, Uncertainty and Profit*, Frank Knight explained that the principles behind insurance practice, namely consolidation and specialization, actually underlay even the basics of production for a market.<sup>164</sup> Knight identified the problem of uncertainty as the central obstacle to rational economic behavior. Uncertainty is reduced by grouping like instances, *i.e.*, consolidation, which can then be subjected to probabilistic calculation. Whereas for the individual, specific instances of uncertainty are unpredictable, when an institution can group instances, it can treat the results as known on the basis of probabilities, and thus plan rationally for the outcomes. Secondly, those institutions that can best group instances are selected to deal with uncertainties. This is known as specialization. Knight went on to explain that while this model of action is the conscious and overt principle in organizing the insurance industry (with insurance companies grouping together the instances of death, uncertain for the individual but highly certain for large groups on the basis of actuarial statistics), the same principle actually explains the relationship of consumers to producers: while individual consumers’ wants are unknown in advance even to the consumers themselves, producers are able to plan for the future by producing for an anonymous group, whose wants can be predicted.

The clue to the apparent paradox is, of course, in the ‘law of large numbers,’ the consolidation of risks (or uncertainties). The consumer is, to himself, only one; to the producer he is a mere multitude in which individuality is lost. It turns out that

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<sup>162</sup> Zelizer, *Morals and Markets*, 89.

<sup>163</sup> Lawrence F. Abbot, *The Story of NYLIC: A History of the Origin and Development of the New York Life Insurance Company from 1845 to 1929*, p. 12 (1930).

<sup>164</sup> Frank H. Knight, *Risk, Uncertainty and Profit* 233-263 (1921). See also Henry Crosby Emery, *Speculation on the Stock and Produce Exchanges of the United States* (Faculty of Political Science of Columbia Univ. ed., 1896).

an outsider can foresee the wants of a multitude with more ease and accuracy than an individual can attain with respect to his own.<sup>165</sup>

The two principles of reducing uncertainty to measurable risk are consolidation and specialization, and each is associated with specific economic institutions or practices. The best known device for dealing with uncertainty through consolidation is insurance, with life insurance being its most highly developed form.<sup>166</sup> And significantly, “[t]he most important instrument in modern economic society for the specialization of uncertainty...is *Speculation*,” with its best illustration in business at large being the hedging contract:

By this simple device the industrial producer is enabled to eliminate the chance of loss or gain due to changes in the value of materials used in his operations during the interval between the time he purchases them as raw materials and the time he disposes of them as finished product, ‘shifting’ this risk to the professional speculator. It is manifest at once that even aside from any superior judgment or foresight or better information possessed by such a professional speculator, he gains an enormous advantage from the sheer magnitude or breadth of the scope of his operations.<sup>167</sup>

Thus, when Justice Holmes calls speculation through the commodities futures markets “the self-adjustment of society to the probable,”<sup>168</sup> or when Professor Patterson devotes an article to legitimating hedging contracts in commodities,<sup>169</sup> they are actually relying on an incipient form of the policy argument fleshed out by economists such as Knight. Speculation, according to this argument, is an important part of the forward motion of a capitalistic market, a sort of engine of the progress of economic rationality. Taken to its extreme, this policy would allow for the development of vocations in risk management, despite the fact that these can be characterized by some as getting something for nothing. But, while it is easy to accept this vision as if it offers a simple and sweeping solution to the tension generated by the law’s antipathy to gambling (by seemingly eradicating that antipathy entirely), it is important to note that the tension is not in fact resolved. And the lack of resolution is not dependent merely on an anachronistic attachment to a pre-modern deterministic or religious world-view. In fact, the policy of limiting gambling advances the goal of constructing acquisitive individuality, nourishing the work ethic which is also presented as a necessary engine of economic progress. In other words, the conflict among policies is not between a pre-market or anti-capitalist policy and a pro-market or capitalist policy; rather, both sides of the policy divide fit squarely into an emerging capitalist society. The policies simply represent conflicting positions within a market oriented

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<sup>165</sup> Knight, *Risk, Uncertainty, and Profit*, 241.

<sup>166</sup> *Id.* at 245-248.

<sup>167</sup> *Id.* at 255-256.

<sup>168</sup> *Chicago Board of Trade v. Christie Grain & Stock Co.*, 198 U.S. 236, 247 (1905).

<sup>169</sup> Edwin W. Patterson, “Hedging and Wagering on Produce Exchanges,” 40 *Yale L.J.* 843 (1931).

society regarding the question of which cultural attributes of that society require the law's support or censure.

If analyzed closely, there are many aspects of the judicial rhetoric just canvassed that would yield clues to the shift to a modern market sensibility, and even a theory of the individual that underlies that shift. While it is impossible to undergo a thorough examination of these issues here, a few brief comments may be suggestive. One example is the issue of time. The opinions examined herein have a special concern with time, and its changing meaning and value. "From the time he plants his seed..." the farmer has lost control of the value of time, and he is gambling.<sup>170</sup> Theorists examining cultural formations have concentrated on the shifting conceptions of time as a central aspect of the shift to modernity.<sup>171</sup> The Marxist cultural theorist Georg Lukacs lamented that industrial capitalism had alienated individuals through a process of reification, a central aspect of which was the reduction of time into an uncontrollable, external influence on people, who were transformed into cogs in a machine. "The contemplative stance adopted towards a process mechanically conforming to fixed laws and enacted independently of man's consciousness and impervious to human intervention, *i.e.* a perfectly closed system, must likewise transform the basic categories of man's immediate attitude to the world: it reduces space and time to a common denominator and degrades time to the dimension of space."<sup>172</sup> Lukacs' fundamental concern seems to be that time, once an intangible and infinitely meaningful quality, is reduced under conditions of industrial capitalism to yet another one-dimensional and measurable function of money. While they did not use the philosophical articulations available to Lukacs, turn-of-the-century judges experienced some of the same impulses. Insurance and commodities trading, with their constant reminders of many "futures" on the one hand, and the promise of turning time into money without intervening production on the other, are contexts where the shifting nature of time heightens the uncertainty and even the fear surrounding a transition to modernity.

Cultural critic Walter Benjamin's work is even more pointed in drawing the connections between time, modernity, and gambling. Writing on Baudelaire, Benjamin

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<sup>170</sup> *Albers v. Lamson*, 42 N.E.2d 627, 630 (Ill. 1942).

<sup>171</sup> See, e.g., Stephen Kern, *The Culture of Time and Space 1880-1918* (1983); Peter Galison, *Einstein's Clocks, Poincaré's Maps: Empires of Time* (2003)

<sup>172</sup> Georg Lukacs, *History and Class Consciousness* 89 (Rodney Livingstone trans., MIT Press 1968) (1923). He continues:

Thus time sheds its qualitative, variable, flowing nature; it freezes into an exactly delimited, quantifiable continuum filled with quantifiable 'things' (the reified, mechanically objectified 'performance' of the worker, wholly separated from his total human personality): in short, it becomes space... On the other hand, the mechanical disintegration of the process of production into its components also destroys those bonds that had bound individuals to a community in the days when production was still 'organic'. In this respect, too, mechanisation makes of them isolated abstract atoms whose work no longer brings them together directly and organically; it becomes mediate to an increasing extent exclusively by the abstract laws of the mechanism which imprisons them.

Id. at 90.

notes that the image of the gambler became the characteristically modern complement to the archaic image of the fencer; both being heroic figures.<sup>173</sup> He then elaborates suggestively that time itself is different in modernity, a difference understood in part by reference to the gambler. Benjamin's critique of modern subjectivity is more layered and complex than Lukacs's. Rather than relying directly on economic form as a motivation of change, Benjamin analyzes the relationship between cultural forms such as architecture, literature and technological innovations, such as assembly line work, comparing the repetition involved in such work to the narcotic effect of gambling.<sup>174</sup> Benjamin's conception of consciousness in modernity links, in a series of complex correspondences, a change in the experience of time with changing cultural conditions from traffic signals to matches to automated factories, and all of these in turn with the experience of the gambler. The gambler becomes emblematic of modernity. The negotiations of the place of gambling in commodities and insurance contracts, then, take their place as part of a change in the notion of individuality, and a construction of a market consciousness that accompanies a shift to modernity. Benjamin quotes these lines of Baudelaire, which seem to draw out the insecurities that animate much of the conscious and unconscious policy discussion in the cases: "Keep in mind that Time's a rabid gambler/Who wins always without cheating – it's the law!"<sup>175</sup>

The policy divide identified in the case law should be read as a cultural conflict central to the capitalist market economy taking shape in the United States around the turn of the century. Both sides in this conflict accepted capitalism as the central mode of economic organization for the country. However, they divided on the question of how to conceptualize risk, and especially on the question of the relationship between uncertainty and the individual. When looked at as a whole, this conflict can be characterized as a love/hate relationship with risk, or an economy of appropriation and distance.<sup>176</sup> The advantage to reading this conflict as such an economy is that it allows us to see expressions of both sides of the policy within the same work; thus, a commitment to an outcome on one side of the policy divide does not cancel the possibility of resorting to rhetoric that favors the other side. It also allows us to read, rather than one case for one judge's view, a discourse and its effects, despite the fact that none of them were willed by any particular actor.

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<sup>173</sup> Walter Benjamin, *Illuminations* 178 (Harry Zohn trans., Schocken Books 1968) (1955).

<sup>174</sup> See id. at 174-85; see also Walter Benjamin, "Paris, Capital of the Nineteenth Century," in *Reflections* 146, 159-62 (Edmund Jephcott trans., 1978) ("To the phantasmagorias of space to which the flaneur abandons himself, correspond the phantasmagorias of time indulged in by the gambler. Gambling converts time into a narcotic.").

<sup>175</sup> Benjamin, *Illuminations*, 179.

<sup>176</sup> By using the term economy, I mean to draw attention to a way of looking at rhetorical maneuvers, not merely as independent isolated arguments, but rather as part of a larger rhetorical structure. The rhetorical structure lends arguments intelligibility, but not every piece of rhetoric that seems to favor a given outcome requires that particular outcome.

Certain descriptions of the development of contract law early in the century point to the centrality of coming to terms with uncertainty.<sup>177</sup> However, these descriptions not only miss the more complex negotiation of cultural models at work in the conflicts over uncertainty, they also fundamentally miscast the role of uncertainty itself as a phenomenon new to contract law as industrial concentrations grow larger.<sup>178</sup> By assuming an objective uncertainty in economic affairs, these descriptions confuse economics with culture. Economic factors may or may not have become more uncertain, but the crisis of uncertainty was cultural.

The most visible feature in the discursive economy of appropriation and distance is the positioning of risk, chance, or hazard, in relationship to contract. On the one hand, all these types of uncertainty are marginalized as objects of contract. Thus, the rhetoric of contract law is at pains, even in its nonchalant repetitions, to show that commodities futures contracts or insurance contracts are in some way a special, marginal category of contracts. They are even given a special appellation, *aleatory contracts*, implying that all other contracts are free from risk and uncertainty. Thus the common refrain that a transaction, whatever its content, is valid, “provided it not be by way of cover for a wager.”<sup>179</sup> This construction masquerades as a simple legal proposition, often presented as a bottom line, and often included in the headnotes of the reports. But we should pause over what it actually entails in the cases. From the sentence itself, we would be tempted to believe that the “wager” is a known quantity, visible to the discerning eye wherever it raises its ugly head. But in fact, in most of these cases, the court spends most of its opinion trying to divine whether the transaction in question is or is not obnoxious to public policy. And recall, this is precisely the question on which the different jurisdictions, and sometimes different courts in the same jurisdiction, simply cannot agree. The courts are

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<sup>177</sup> See, e.g., Melvin Aron Eisenberg, “Probability and Chance in Contract Law,” 45 *U.C.L.A. L. Rev.* 1005 (1998); Walter F. Pratt, Jr., “American Contract Law at the Turn of the Century,” 39 *S.C. L. Rev.* 415 (1988).

<sup>178</sup> As Knight shows, the increase of industrial concentration and the rise of larger institutions that can group instances (whether of deaths or of consumer demand) actually decrease the objective manifestations of uncertainty. Legal scholarship often takes the rise in the importance of uncertainty in legal rhetoric at face value, simply assuming that an industrial economy generates more uncertainty than some idealized, simpler economy. From my perspective, it is more interesting to inquire into why uncertainty becomes such an important category for legal thought.

<sup>179</sup> *Hawkes v. Mobley*, 163 S.E. 494, 497 (Ga. 1932). For additional cases using substantially the same construction, i.e., calling the transaction valid provided it not be done by way of cover for a wager, see, e.g., *Prudential Ins. Co. of Am. v. Williams*, 168 S.W. 1114, 1115 (Ark. 1914); *Page v. Metropolitan Life Ins. Co.*, 135 S.W. 911, 912 (Ark. 1911); *Rylander v. Allen*, 53 S.E. 1032, 1036 (Ga. 1906); *Guaranty Life Ins. Co. v. Primo*, 140 S.E. 780, 781 (Ga. App. 1927); *Volunteer St. Life Ins. Co. v. Buchanan*, 73 S.E. 602, 604 (Ga. App. 1912); *Elkhart Mut. Aid Benevolent Relief Ass’n v. Houghton*, 2 N.E. 763, 767 (Ind. 1885); *Reilly v. Penn Mut. Life Ins. Co.*, 207 N.W. 583, 585 (Iowa 1926); *Chamberlain v. Butler*, 86 N.W. 481, 483 (Neb. 1901); *Mechanics’ Nat. Bank v. Comins*, 55 A. 191, 195 (N.H. 1903); *Empire Development Co. v. Title Guarantee & Trust Co.*, 121 N.E. 468, 469 (N.Y. 1918); *In re Phillips’ Estate*, 86 A. 289, 290 (Pa. 1913); *Cronin v. Vermont Life Ins. Co.*, 40 A. 497, 497 (R.I. 1898); *Roberts v. National Benefit Life Ins. Co.* 148 S.E. 179, 180 (S.C. 1929); *Rogers v. Atlantic Life Ins. Co.*, 133 S.E. 215, 217 (S.C. 1926); *Crosswell v. Connecticut Indem. Ass’n*, 28 S.E. 200, 201 (S.C. 1897); *Shoemaker v. Harrington*, 30 S.W.2d 539, 543 (Tex. Civ. App. 1930); *Manhattan Life Ins. Co. v. Cohen*, 139 S.W. 51, 54 (Tex. Civ. App. 1911).

engaged in a constructive process of naming certain contracts “wagers,” or allowing those contracts to escape that label. But while this process goes on, the refrain allows the courts to repeat the mantra, implying that while there is a question as to the legitimacy of each and every transaction, the “mere wager”<sup>180</sup> itself is always a marginal, exterior category, which has no home within contract.

The language of marginalization is the rhetoric of containment and mastery. On its face, it implies complete control. The very act of incessant, nearly compulsive repetition, found in almost every jurisdiction, implies that the law controls the wager, and thus, even chance itself. Rhetorically, wager is controlled, tamed, expelled from contract discourse. But this almost ritualistic repetition is only a substitute for the control of gambling that the law cannot achieve.<sup>181</sup>

On the other hand, an opposed rhetoric is also at work, dispersing or disseminating the wager rather than marginalizing it. Instead of claiming that the uncertainty inherent in gambling is somehow exterior to contract, this rhetoric claims it is the essence of contract, and even that contract can be defined as the assumption of risk. This view is at least as old as Holmes’ *The Common Law*,<sup>182</sup> and is popular today in the contract opinions of Chief Judge Richard Posner.<sup>183</sup> Indeed, it has become a commonplace of legal opinions to speculate on the ubiquity of something akin to gambling in contract specifically, and in economic life generally. A rich example, complete with literary allusion, comes from a case regarding a joint venture in stock investment:

Except for those endowed with the blessings of prescience or omnipotence, the agreements of all men as to the future depend on some degree upon chance and unknown and fortuitous events.

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<sup>180</sup> Courts also favor this construction when attacking wagering, in the abstract.

<sup>181</sup> In this, the courts reenact the child’s game of disappearance and return, fort-da, described by Freud in *Beyond the Pleasure Principle*. There, the child enacts the controlled disappearance and return of his toys in order to compensate himself for his mother’s disappearance, which is beyond his control. See Sigmund Freud, *Beyond the Pleasure Principle* 12-17 (James Strachey ed. & trans., W.W. Norton & Co. 1961) (1920).

<sup>182</sup> See Oliver Wendell Holmes, Jr., *The Common Law* 299-301 (1881) (“In the case of a binding promise that it shall rain to-morrow, the immediate legal effect of what the promisor does is, that he takes the risk of the event, within certain defined limits, as between himself and the promisee. He does no more when he promises to deliver a bale of cotton.”) *Id.* at 300.

<sup>183</sup> See, e.g., *Nicolet Instrument Corp. v. Lindquist & Vennum*, 34 F.3d 453, 456 (7th Cir. 1994) (“It is not a novel idea that an essential function of contracts is to allocate particular risks to the parties best able to bear them...”); *Market Street Assocs. v. Frey*, 941 F.2d 588, 595 (7th Cir. 1991) (contrasting contractual functions of allocation of risk on the one hand and setting in motion of a cooperative enterprise on the other); *Spartech Corp. v. Opper*, 890 F.2d 949, 955 (7th Cir. 1989) (“A principle purpose of contracts... is to allocate the risk of the unexpected... not to place it always on the promisee.”); *Northern Ind. Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 275-78 (7th Cir. 1986) (asking how the parties would have assigned the risk that the performance of the contract might become impossible); *Fidelity and Deposit Co. v. City of Sheboygan Falls*, 713 F.2d 1261, 1269 (7th Cir. 1983) (“An important function of contracts is to allocate risk; and the performing party to a contract usually guarantees performance against at least some contingencies that are beyond his control.”).

‘The best laid schemes o’ mice and men / Gang aft a-gley;  
An lea’e us nought but grief and pain, / For promis’d joy.

One of our most substantial and respected businesses, insurance, is premised upon the most unknowable and unpredictable contingency of all – death. The stock market, as a barometer of business success, international and domestic outlook, sales, taxes, profits, competition, and a hundred variables, not the least of which is the irrationality of mass psychology, is a notoriously volatile indicator whose fluctuations, largely beyond individual control, bestow fortunes on some men while leaving others shattered and penniless. Chancy, yes. A gamble in the legal sense rather than the vernacular, no. ‘Business may involve speculation but unless the latter is illegal it does not get down to what in modern times is the lower classification known as gambling.’ Risk, then, is not the element which makes the transaction a gamble.<sup>184</sup>

Contract law, then, has learned to live with risk. It has set itself up as a higher order, to be contrasted with that “lower classification,” gambling. Contract discourse has taken the teeth out of gambling, devolving “chance and fortuitous events” in the first sentence quoted above into a mere colloquialism, “chancy,” later in the passage. Chance intrudes everywhere in life, but only in a moderate, controlled fashion, at least as far as the “legal sense rather than the vernacular” is concerned.

This quotation is only a hint of the fact that insecurity over the status of speculative transactions arises in almost the same form today, regarding two distinct contexts closely analogous to the turn of the century cases discussed here. The first context is activity in the market for complex derivatives; the second is the new industry of viatical settlement. A brief word regarding these two issues should suffice to show that while attitudes toward gambling have changed over the last hundred years, the basic problematic of distinguishing legitimate risk allocation from illegitimate speculation is still alive and unsettled, and perhaps unsettling.

The market for financial instruments known as derivatives has grown to staggering proportions since the early 1980’s.<sup>185</sup> For the most part, this growth is perceived as part of an extension of the rationalization of pricing risk. However, periodically, scandals involving huge losses plague the industry and generate a different kind of discourse.<sup>186</sup> Popular discourse surrounding the derivatives markets, particularly following scandals, is

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<sup>184</sup> *Liss v. Manuel*, 296 N.Y.S.2d 627, 630-631 (Civ. Ct. 1968) (citation omitted).

<sup>185</sup> The derivatives market was estimated to have a notional value of \$70 trillion in 1998, 100 trillion in 2000, and 340 trillion in 2005. See Bank for International Settlements Quarterly Review, Sept 2005, available at <http://www.bis.org/publ/quarterly.htm>.

<sup>186</sup> Among the more publicized scandals in derivatives trading are the collapse of Barings Bank in 1995, the bankruptcy of Orange County, California, in 1994, the losses incurred by Procter and Gamble and Gibson Greetings Inc. in derivatives trades with Bankers Trust in 1994, and the collapse of the Long Term Capital “hedge fund” in 1998. For an account of the tendency of derivatives markets to resemble gambling, see Timothy L. O’Brien, *Bad Bet: The Inside Story of the Glamour, Glitz, and Danger of America’s Gambling Industry* (1998).

full of references to betting and gambling, and to the fact that investment and gambling are difficult to distinguish, “since all financial products straddle that very fine line separating temperate, calculated gambles from irrational, impassioned betting.”<sup>187</sup> Each new scandal brings with it a call for tighter regulation, with its familiar dynamic of paternalism pitted against those who claim that flexible self-regulation will always be more efficient.<sup>188</sup> Finally, defenders of the derivatives markets today make a claim for specialization and expertise, reminiscent of Justice Holmes’ crocodile tears over the fact that “the success of the strong induces imitation by the weak, and that incompetent persons bring themselves to ruin by undertaking to speculate in their turn.”<sup>189</sup> The moral aversion to gambling has dissipated, but the theoretical difficulty of determining the proper way to regulate the market in risk lives on.<sup>190</sup>

The difficulty in regulating the assignment of life insurance replays itself even more starkly. Over the last decade, a “new” industry of viatical settlement has sprung up. Viatical settlements are agreements to buy insurance policies from terminally ill policy holders, usually people suffering from AIDS, for a percentage of the value of the policy, typically between fifty-five and seventy per cent of the face value of the policy.<sup>191</sup> In essence, viatical settlements are identical to the assignments of life policies discussed above, except that the AIDS epidemic has created a population base in dire need of cash, primarily for medical expenses, before the policies mature (at death). Seeing the potential

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<sup>187</sup> Id. at 274. For journalistic accounts of investment in derivatives characterized as betting, see, e.g., Michael Lewis, “How the Eggheads Cracked,” *N.Y. Times Mag.*, Jan. 24, 1999, at 24; Steven Lipin et al., “Fancy Footwork: Bankers Trust Thrives Pitching Derivatives, But Climate Is Shifting,” *Wall St. J.*, Apr. 22, 1994, at A1; Steven Lipin et al., “Portfolio Poker: Just What Firms Do With Derivatives Is Suddenly a Hot Issue,” *Wall St. J.*, Apr. 14, 1994, at A1; Robert Trigaux, “Firms’ Stretch for Profits Could Backfire,” *St. Petersburg Times*, Apr. 14, 1994, at 1E.

<sup>188</sup> See, e.g. Jaye Scholl, “The Big Fizzle: Beware of Leveraged Rocket Scientists with an Attitude,” *Barron’s*, Sept. 28, 1998, at 23; Randall Smith and Steven Lipin, “Beleaguered Giant: As Derivatives Losses Rise, Industry Fights to Avert Regulation,” *Wall Street Journal* A1, August 25, 1994, at A1; Steven Lipin and Anita Raghavan, “GAO to Join Hot Debate on Derivatives,” *Wall St. J.*, May 19, 1994, at C1.

<sup>189</sup> *Board of Trade v. Christie*, 198 U.S. 236 (1905).

<sup>190</sup> One recent article on the issue claims, using economic analysis, that pre-1930’s antipathy toward gambling may have had its basis in efficiency, and that the current support for lax regulation of speculative transactions in derivatives may be economically unsound. See Lynn Stout, “Why the Law Hates Speculators: Regulation and Private Ordering in the Market for OTC Derivatives,” 48 *Duke L.J.* 701 (1999). Legal scholarship surrounding derivatives sometimes touches on the gambling issue, but it is more often focused on the question of whether derivatives can be regulated by federal authorities as securities. See *Procter & Gamble Co. v. Bankers Trust Co.*, 925 F. Supp. 1270 (S.D. Ohio, 1996); see also William K. Maready, Jr., “Comment, Regulating for Disaster: Federal Attempts to Control the Derivatives Market,” 31 *Wake Forest L. Rev.* 885 (1996).

<sup>191</sup> See Timothy P. Davis, “Should Viatical Settlements Be Considered ‘Securities’ Under the 1933 Securities Act?” 6 *Kans. J.L. & Pub. Pol’y*, 75 (1997). See also Dave Luxenberg, “Comment, Why Viatical Settlements Constitute Investment Contracts Within the Meaning of the 1933 & 1934 Securities Acts,” 34 *Willamette L. Rev.* 357 (1998).

for profits, the industry has grown at a very rapid pace,<sup>192</sup> and is expanding its client base from AIDS patients to numerous terminally and chronically ill patients.<sup>193</sup> While most of the legal discourse, again, revolves around the question of how to regulate the viatical industry,<sup>194</sup> one commentator opened her discussion with the claim that “Viatical companies gamble on people’s lives,”<sup>195</sup> and another notes that, “Critics claim that it is ‘ghoulish’ to allow companies to financially succeed by gambling on the life expectancies of others.”<sup>196</sup> The focus of the discussion has shifted, gambling has been displaced as the center of regulatory discourse, but the core conflict over what kinds of speculation will be deemed legitimate retains its resonance.

I have focused on a transformative moment in the development of contract law where the question of gambling was eventually swallowed and internalized as if the problem were solved. What has come to light, instead, is that the conflict over what was gambling and what was allocation of risk was handled, and settled, not according to an analytical formula that successfully distinguished between them, but rather through a more complex and less decisive cultural negotiation and displacement of the question. The close reading of judicial rhetoric I have engaged in serves to show that legal discourse is a productive endeavor. More than straightforward prohibitions on certain types of conduct, judicial grappling with risk and uncertainty offers its audiences an image with which to identify; rhetoric does not stop at telling us what to do, it tells us what to be.

Today, the gambling label is less of a stigma, not only for dubious financial transactions, but even for plain, straightforward gambling, which has been legalized in almost all the states in some form, from numbers (the state lotteries) to poker (casino gambling). All of these legalized forms are seen as productive economic endeavors, at least as much as any of the rest of the entertainment industry. In the modern setting then, the normative question of the legitimacy of specific types of transactions is not played out by arguing over whether they are gambling (everyone is willing to admit they are), but rather, is displaced into the question of how they should be regulated, and particularly,

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<sup>192</sup> Viatical settlements were estimated at \$5 million in 1989, \$500 million in 1996, and were projected to grow to \$4 billion by the year 2000. Miriam R. Albert, “Selling Death Short: The Regulatory and Policy Implications of Viatical Settlements (Symposium on Health Care Policy: What Lessons Have We Learned from the AIDS Pandemic?),” 61 *Alb. L. Rev.* 1013, 1018 (1998); Joy D. Kosiewicz, “Comment, Death for Sale: A Call to Regulate the Viatical Settlement Industry,” 48 *Case W. Res. L. Rev.* 701 (1998).

<sup>193</sup> Kosiewicz, “Death for Sale,” 725.

<sup>194</sup> See *SEC v. Life Partners, Inc.*, 87 F.3d 536 (D.C. Cir. 1996); Davis, “Should Viatical Settlements Be Considered Securities;” Luxenberg, “Why Viatical Settlements Constitute Investment Contracts;” Michael R. Davis, “Note, Unregulated Investment in Certain Death: *SEC v. Life Partners, Inc.*,” 42 *Vill. L. Rev.* 925 (1997); Katherine DePeri, “Recent Decisions: Brokered Viatical Settlement Contracts Are Not Securities,” 70 *Temp. L. Rev.* 857 (1997); Elizabeth L. Deeley, “Note, Viatical Settlements Are Not Securities: Is It Law or Sympathy?” 66 *Geo. Wash. L. Rev.* 382 (1998); Shanah D. Glick, “Comment, Are Viatical Settlements Securities Within the Regulatory Control of the Securities Act of 1933?” 60 *U. Chi. L. Rev.* 957 (1993).

<sup>195</sup> Kosiewicz, “Death for Sale,” 701.

<sup>196</sup> Denise M. Schultz, “Comment, Angels of Mercy or Greedy Capitalists? Buying Life Insurance Policies from the Terminally Ill,” 24 *Pepp. L. Rev.* 99, 103 (1996).

whether they should be regulated by the ultimate father figure, *i.e.*, the federal government in the shape of the Securities and Exchange Commission or the Commodities Futures Trading Commission. This displacement represents a shift of the same normative debate, over how and how heavily transactions of this sort should be regulated and (the other side of the coin) enforced.

Commenting on the workings of legal discourse as an ideological function, Robert Gordon has argued that lawyers' main importance derives from their contribution to the forms and categories of public discourse.<sup>197</sup> Judicial discourse surrounding the problem of gambling in contract law around the turn of the century was involved in such an ideological function. By spinning out an economy of appropriation and distance with regard to risk, chance and hazard in the economic processes of contracting, contract discourse helped its audiences come to terms with the deep fears and uncertainties that accompanied the transition into modernity. By retaining its condemnatory critique of gambling, or "banishing its gambling doubles,"<sup>198</sup> it played the protector of souls. And by recognizing that efficient economies required speculative activity, and that an element, albeit a controlled element of gambling existed in all economic activity, contract discourse made way for the emergence of an individual who could claim mastery even while acknowledging uncertainty. Throwing itself between the devil and the deep sea, contract helped Americans stop worrying and learn to love risk.

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<sup>197</sup> Robert W. Gordon, "Legal Thought and Legal Practice in the Age of American Enterprise, 1870-1920," in *Professions and Professional Ideologies in America* 81-82 (Gerald L. Geison, ed., 1983).

<sup>198</sup> Fabian, *Card Sharps*, 5.

## CONCLUSION: UNDERMINING THE METAPHYSICS OF CONTRACT

In *Shakespeare: The Invention of the Human*, Harold Bloom recently argued that our fundamental sense of the meaning of humanity, of the multiplicity and conflict within personality, are shaped and forever changed by Shakespeare's plays. Of course, there were human beings before the bard's birth; but Shakespeare's portrayals of character changed our conception of humanity so fundamentally that it is difficult to imagine what came before, or how it could have been otherwise.<sup>1</sup> A similar dynamic is at stake in the relationship between contract and the individual.

Students of economic and political thought have long mused over the processes through which the west learned to imagine individuals as rational, autonomous, calculating, and finally, calculable. These processes have their roots as far back as the sixteenth century, and go hand in hand with an ever expanding vision of a market peculiarly hospitable to these abstract, calculating creatures.<sup>2</sup> Late nineteenth century contract law took shape in the conflicts that were the culmination of this process of imagining the individual subject. That vision of contract, and that imagination of the subject, in turn govern the way Americans think about contract up to today.

This formulation raises two different kinds of questions: first, what is the content of this imagined subject? Second, how does the process of imagining the individual subject take place in the contractual arena?

The calculating subject is the individual with market consciousness, for whom most things can be reduced to market goods and their ultimate and ultimately abstracted measure, money. Writing at the turn of the twentieth century, Georg Simmel remarked that one could "characterize the intellectual functions that are used at present in coping with the world and in regulating both individual and social relations as *calculative* functions."<sup>3</sup> For Simmel, money is both the key to the process of becoming calculable, and the ultimate example of the kind of abstraction that cleanses objects of character. Importantly, the abstract form that represents the value of objects eventually "reflects upon the objects themselves.":

If it is true that the art of a period gradually determines the way we look at nature, and if the artist's spontaneous and subjective abstraction from reality forms the apparently immediate sensuous picture of nature in our consciousness, then so too

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<sup>1</sup> Harold Bloom, *Shakespeare: The Invention of the Human* 4-7; 12-17 (1998).

<sup>2</sup> Two of the most provocative and enlightening accounts of these processes are Max Weber, *The Protestant Ethic and the Spirit of Capitalism* (Talcott Parsons trans., 3d ed. 1985) and Albert O. Hirschman, *The Passions and the Interests* (1977).

<sup>3</sup> Georg Simmel, *The Philosophy of Money* 444 (Tom Bottomore & David Frisby trans., David Frisby ed., 2d ed. 1990) (1900).

will the superstructure of money relations erected above qualitative reality determine much more radically the inner image of reality according to its forms.<sup>4</sup>

The system of exchange prevalent in a developed money economy encourages recurring descriptions of objects in terms of their money value, and that in turn leads to their appreciation or understanding primarily as holders of such value, fungible in all senses. Money describes value, and objects increasingly correspond to its rationalization, precision, and calculation.

Contract at the turn of the century takes part in this same economy of generating calculability. The imagined individual of theoretical contract discourse begins as an abstraction describing the real world persons, natural and corporate, who engage in contractual activity. But this image does not stop at description. Instead, it transforms the objects it purports to describe. The “inner image of reality” is transformed as it sheds the characteristics of communal connection, passion, anxiety, beneficence, trust, in favor of precision and cold calculation.

Perhaps the leading contemporary ideologue of free contract summed up this vision: “[I]n the United States more than anywhere else, the social structure is based on contract, and status is of the least importance. Contract, however, is rational – even rationalistic. It is also realistic, cold, and matter-of-fact...In a state based on contract sentiment is out of place in any public or common affairs.” The individual in such a state is an “isolated man,” independent and sovereign; he has sloughed off ties to family, leaving himself relations that are “open and free, but...also loose.” His personal independence has led him to the point where he has only a minimal need for government, no need of labor unions, and indeed he has reached “the point where personal liberty supplants the associative principle.”<sup>5</sup>

Classical contract theory took its cues from such a vision of the individual, first by positing this idealization as a working assumption and then reinforcing the image by relying on it as a justification for particular rules. But the idealized image was never an accurate description; indeed, acknowledged as an abstraction, it never needed aspire to accuracy. The image constructed by contract discourse at once denied interdependence and highlighted autonomy.

One source of interdependence denied by contract discourse was the world of relational pairs, whose incidences were determined by law. Relational pairs – *master-servant*; *landlord-tenant*; *bailor-bailee*; *principal-agent*; even *husband-wife* – appeared to contract theorists as tainted by the concept of status, and indeed by a world where interdependence was dangerously close to dependence and subservience. With the institutions of slavery and coverture still fresh in their collective legal consciousness, the

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<sup>4</sup> Id. at 445.

<sup>5</sup> William Graham Sumner, *What Social Classes Owe to Each Other* 25; 39; 96 (photo. reprint 1972) (New York, Harper & Brothers 1883). See also Amy Dru Stanley, *From Bondage to Contract* 1-4 (1998).

associations of classical theorists between relational pairs and dependence was understandable.

And so, classical theorists developed a *general* theory of contract that in fact limited the scope of the contract idea. Labor and employment and bailment and marriage and a host of other relationships would be pushed out of what antebellum legal scholars had imagined as the realm of contract. More importantly for our purposes here, the image of the contracting individual changed the taken-for-granted background of contract discourse. For Parsons, writing at mid-century, contract ranged so broadly as to encompass even the duties of care between parent and infant. Such contractual obligation

is implied by the cares of the past, which have perpetuated society from generation to generation; by that absolute necessity which makes the performance of these duties the condition of the preservation of human life; and by the implied obligation on the part of the unconscious object of this care, that when, by its means, they shall have grown into strength, and age has brought weakness upon those to whom they are thus indebted, they will acknowledge and repay the debt.<sup>6</sup>

Contract was “coordinate and commensurate with *duty*;” it was animated by “common principles which all are supposed to understand and acknowledge;” it connected all members of society in “the web and woof of actual life.”<sup>7</sup> The distance between this antebellum individual subject and classical theory’s “isolated man” is great indeed, not only at the level of imagery, but also at the level of legal rules. Could we even imagine a greater divide than that between Parsons’s discussion of the obligation implied by the cares of the past and the steadfast statement of classical theorists that past consideration is no consideration?

But the image of interdependence rooted in the past was only half the problem for classical theory. Just as threatening was a new type of interdependence looming in the not so distant future in the shape of corporate capitalism and most pointedly in its managerial organization of work. The turn of the twentieth century saw a rise in economic concentration, and with it a limitation of “ruinous competition” and an accelerated shift in employment patterns: more and more Americans worked for a small number of (giant) corporations. And the workplace was increasingly managed not by skilled workers themselves serving as shop foremen with wide discretion over work practices, but rather by an army of management engineers, equipped with a scientific technique explicitly designed to rationalize the workplace.<sup>8</sup>

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<sup>6</sup> 1 Theophilus Parsons, *The Law of Contracts* 3–4 (1st ed., Boston, Little, Brown & Co. 1853).

<sup>7</sup> *Id.* at 4.

<sup>8</sup> See David Montgomery, *The Fall of the House of Labor: The Workplace, the State, and American Labor Activism, 1865-1925*, pp. 214-56 (1987); Naomi R. Lamoreaux, *The Great Merger Movement in American Business, 1895-1904*, pp. 1-13 (1985); Alfred D. Chandler, Jr., *The Visible Hand: The Managerial Revolution in American Business* 411-14; 484-93 (1977); John Fabian Witt, *The Accidental Republic: Crippled Workingmen, Destitute Widows, and the Remaking of American Law* 103-09 (2004); James

Two aspects of this transformation bear emphasis. First, economic concentration under the corporate form had wide ranging *cultural* effects. It changed not only business practices, but also people's perceptions of the shape of the market, the social body and its elements. Critics of economic concentration as well as its most ardent proponents were joined in understanding the rise of the corporation as entailing the decline of entrepreneurial capitalism and with it, the decline of the freeholder or small producer as the model of the modern subject. Journalist and cultural critic Walter Lippmann, for example, claimed that corporate concentration was "sucking the life out of private property," and that theories of autonomous personality based on older notions of property would have to be reexamined if not discarded altogether. John D. Rockefeller understood the significance of the new corporate order in even simpler terms: "The day of combination is here to stay. Individualism is gone, never to return."<sup>9</sup>

Second, just as the number of people working in large industrial concerns was mushrooming, scientific management was cutting away at the individuality and the autonomy of the worker. Frederick Winslow Taylor, one of the founders of scientific workplace management, claimed that scientific management involved "a great mental revolution," a revolution geared perhaps more towards managers than workers. With actual production processes broken down to the minutest details of physical movement, workers often felt like they were being reduced to parts in a machine, and new managers were encouraged to view laborers instrumentally. While some would rail against the mechanization of the worker's body as others would hail the advent of new levels of cooperation, one thing was clear: the decline of the individual. As Taylor testified before Congress in 1912, the new scientific management would be "entirely impossible with the independent individualism which characterizes the old type of management."<sup>10</sup>

Against this background, the legal arena was one more locus of cultural engagement over the shape of the individual. As John Witt has recently shown, one of the key inroads that scientific management would make in transforming traditional individualism was through workmen's compensation programs. These programs enhanced managerial responsibility and with it managerial control, and their working principle was that workplace accidents and consequently employees had to be managed in the aggregate, rather than as individuals. Lawyers were quick to understand that sanctioning workmen's compensation programs would erode at least the legal image of individualism and personal responsibility embedded in tort law. By the mid 1910's, however, the battle over

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Livingston, *Origins of the Federal Reserve System: Money, Class, and Corporate Capitalism, 1890-1913*, pp. 55-57 (1986).

<sup>9</sup> Walter Lippmann, *Drift and Mastery: An Attempt to Diagnose the Current Unrest* 45 (William E. Leuchtenburg ed., 1961) (1914); Rockefeller quoted in Alan Trachtenberg, *The Incorporation of America: Culture and Society in the Gilded Age* 86 (1982). See also James Livingston, *Pragmatism and the Political Economy of Cultural Revolution, 1850-1940*, pp. 66-77 (1994).

<sup>10</sup> Frederick Winslow Taylor, "Taylor's Testimony Before the Special House Committee," in *Scientific Management* 30-31; 76 (1947). See also Livingston, *Pragmatism and Cultural Revolution*, 89-95.

workmen's compensation had been fought, and the legitimacy of workmen's compensation statutes had been established.<sup>11</sup>

Classical contract theory was wary of interdependence in both these forms, but it reached out both to the past and the future in order to build an image of the contracting individual. The imagined individual subject of classical theory was in part an allusion to the republican tradition. This was the individual imagined as self-possessed property holder, sole entrepreneur, responsible and independent. Indeed, this aspect of the contracting subject is figured quite precisely in what historians refer to as free labor ideology.<sup>12</sup> The actual existence or prominence of such a contracting subject is secondary; the figure of such a subject was clearly salient, its image forming a clear point of identification in building a theory of contract.

The other aspect of classical theory's imagined individual was forward looking, embodying a spirit of calculative rationality difficult to imagine prior to the classical period. Interestingly, the spirit of calculation is closely analogous to that evinced in scientific management itself. The cardinal feature of the calculative ideal is the ability to make decisions on the basis of functional equivalents, which requires that the decision-making agent be able to make accurate and precise comparisons among the elements of exchange. The structurally necessary condition for such calculation, as the founders of modern sociology have famously shown, is a developed money economy. But while money is a necessary condition, by itself it is not sufficient. In order for calculation to take hold, market actors must be able to view exchanges abstractly, paring away extraneous features that threaten to cloud the essence of exchanging values. In its purest form, calculation entails a leveling of all goods, services, assets, or utilities potentially available to an individual. For the calculating attitude to be complete, all qualitative differences are erased, and all things may be compared as values, endlessly interchangeable for one another.<sup>13</sup>

Classical contract assumed contractors who could calculate in this abstract manner, not as a matter of description, but as a matter of theory. The assumption of calculation is encapsulated in the theory of consideration, which at once strips the past of meaning (past consideration is no consideration) and at the same time assumes equivalence while denying the law's capacity for examining consideration's adequacy. The refusal to examine the adequacy of consideration is a statement of contract law's confidence that contracting parties always calculate and trade on the basis of constitutively equivalent values. What

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<sup>11</sup> See Witt, *Accidental Republic*, 109-22; 171-86.

<sup>12</sup> See, e.g., Christopher L. Tomlins, *Law, Labor, and Ideology in the Early American Republic* 259-92 (1993); Robert J. Steinfeld, *The Invention of Free Labor* 147-56 (1991); Stanley, *From Bondage to Contract*, 1-10.

<sup>13</sup> See Simmel, *Philosophy of Money*, 443-46; 1 Max Weber, *Economy and Society* 80-94; 107-09 (Guenther Roth & Claus Wittich eds., 1978).

Ian Macneil has called “presentation” or the bringing of future value to a present exchange, is an additional aspect of contract’s commitment to the calculating attitude.<sup>14</sup>

Clearly, few human beings actually approach this calculative ideal. However, there is a contracting individual who more closely aspires to it: the corporation. The corporation, as disembodied individual subject, comes close to assuming the powers of abstraction and calculation that contract theory lays at its own foundations. The corporation ignores affective ties with impunity (and without pangs of conscience), indeed advancing as its virtue the seeking of profit for its shareholders. It can plausibly be characterized as single-minded. To adapt Karl Polanyi’s phrase, it subordinates society to the market.<sup>15</sup> And thus, it is the corporation that becomes the model of contractual man. But if the corporation is the imagined individual of modern contract, and if, to turn a phrase on its head, contract would become the nexus of corporations, what place would autonomy hold in the vision of contract? Would justifications of contract that rely on autonomy have a place in a world of contract based on the corporation as the contracting subject?

To sum up: The abstracted ideal subject of classical contract teetered on a precarious perch between two different forms of interdependence, one based in the past; the other, in the future. The past was the interdependence of standardized relationships, of local communities, of a well regulated society; the future would be the interdependence of large scale industrialized society, of man in the organization. At the same time, the idealized subject reached out to two different images of independence and autonomy, one culled from the past and one in the process of becoming. From the past came the republican image of the self-possessed individual, the product of free labor ideology; from the future, the ultra-rational calculator. The work of creating the individual subject in contract discourse may then be seen as double: on the one hand, a distancing from past and future (in short, from history); on the other, an appropriation of idealized elements of that same history. The case-law is not the advancement of a position in these debates, but rather a locus of cultural conflict. It exhibits a working through, a negotiation, an endless series of reformulations of possibilities of the position of the subject, together working toward a mediation of conflicting visions.

I have concentrated on three realms in which the calculating subject was conjured and reinforced by the classical revolution in the conception of contract. By banishing gift promises from the kingdom of the enforceable, contract theory helped purge the complex entanglements of the past. Rationalizing consideration doctrine meant limiting the ways in which obligations based on family and friendship, rather than calculable economic

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<sup>14</sup> “Presentation is a way of looking at things in which a person perceives the effect of the future on the present... [T]he presentation of a transaction involves restricting its expected future effects to those defined in the present, *i.e.*, at the inception of the transaction.” Ian R. Macneil, “Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law,” 72 *Nw. U. L. Rev.* 854, 863 (1978). See generally Ian R. Macneil, *The New Social Contract* (1980).

<sup>15</sup> See Karl Polanyi, *The Great Transformation* 68-76 (1944).

interaction, could be recognized and integrated into legal duties. By internalizing the logic of speculation and insurance, contract provided for the taming of an uncertain present. Statistical calculation, based on the law of large numbers, of the chances of rise and fall in value or of life and death, fed the illusion of a world susceptible to scientific management. Finally, by positing the contracting parties as the sole source of obligations, a formal vision of contract put the individual in control of a future he may never have considered.

So how does this calculating subject become the individual of contract? As should be clear, it is not a question of a particular doctrinal rule being adopted or rejected. No rule of contract law could establish the image of the autonomous individual as the subject of contract. In that sense, there is no position within the discourse upon which the shape of the individual turns. This is because subjects are created by discourse itself, and not by a position within that discourse. It is not the articulation of any particular argument in the debates over contract rules that creates the individual, but rather the framework of the debate itself. And the framework, by its very ubiquity, becomes almost unseen, nearly invisible. In this sense, imagining the individual is an ideological project: the “individual” is a role in the drama of private ordering. That role is created by the balance of positions in a discourse, a discourse whose persuasive force hinges on its ability to veil its own constitutive power.

The work of the classical revolution in contract was to establish a new framework for the debate of contractual questions. This framework in turn, at once relied on and established a new contractual subject: autonomous, calculating, and calculable. The success of the framework lay in establishing the parameters for argumentation. The framework was formal, then, in just the sense that formality is considered in art, as Bloom and Simmel both tell us. It establishes the rules of relevance, the criteria of visibility. Validity of the contractual relation turns, within the new framework, on bargains that make up economic exchange. Personal loyalties, moral obligations, and familial connections are expunged. The fear of damnation is submerged into the mechanics of a rational coping with risk. The indeterminacy of the future is reduced to an all-encompassing exchange of entitlement at the moment of contract formation. We become interested only in the question of the presence of a formal bargain. Finally, we translate the idea of the formal bargain into an undertaking that can only be adopted by a willing free agent, and we label the undertaking a promise.

Thus, with contractual obligation having been engulfed by the classical framework, it is widely accepted, within legal academia and outside it, that contract law is about enforcing promises.<sup>16</sup> That acceptance is the first measure of the success of the classical revolution in contract thinking. More than positing a new definition of contract, the

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<sup>16</sup> One clear indication stems from definitions: Pollock’s definition discussed at length in chapter one became the basis for the most traditional and widely accepted American definitions of contract. See *Restatement of Contracts* § 1 (1932) (“A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.”); *Restatement (Second) of Contracts* § 1 (1981) (same); 1 Samuel Williston, *The Law of Contracts* § 1 (1st ed. 1920) (“A contract is a promise, or set of promises, to which the law attaches legal obligation.”).

classical revolution was so sweeping as to generate a reinterpretation of the history of contract.<sup>17</sup> Based on an understanding instilled in every student of contract since the late nineteenth century, we have all been trained to read the history of contract backwards, as the often misunderstood but finally perfected art of enforcing promises. It has become nearly impossible to read the history of contract without initially conceiving of contract as an issue of enforcing promises, whence the necessity of dividing promises into the enforceable and unenforceable kinds. In this sense, the classical thinkers established a metaphysics of contract, reasoning that earlier conceptions of contract were primitive, unperfected, incomplete, but that the real basis of contract was eternal.

My claim in this book has not been that all such views are based on a misunderstanding. Indeed, as much as it is a mode of economic regulation, contract is a conception, an intellectual construct: it is primarily what people believe it to be. The popular belief is not wrong. But there may be better beliefs available, if someone has the impulse to look. This book does not seek to establish an alternative metaphysics of contract. It does, however, suggest that it would be more useful to think about contract as a framework for cooperation, the central element of which is the set of relationships whose terms are potentially regulated by the state.<sup>18</sup> This conception is both a better account of judicial practice, and a way to improve on that practice by ridding it of those commitments that have the effect of limiting contract's fairness-promoting, or redistributive potential.<sup>19</sup> Contract is a conception, and thus, it may be reconceived, or reimagined. A prod to our imagination, and a reminder that the current conception is neither timeless nor transcendent, is the fact that only a hundred and fifty years ago, contract was conceived of quite differently. The transformation of contract is tied to complex economic and social changes, but its technical doctrinal manifestation is visible in the work of classical theorists. My claim here has been that what classical contract theory undertook piecemeal, it achieved wholesale. The rhetorical framework that made enforcing promises into the centerpiece of contract retains its power today, and perhaps is the major factor limiting contract's transformative potential.

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<sup>17</sup> Grant Gilmore famously commented that classical scholars, primary among them Holmes, Langdell, and Williston, had to perform "major surgery" on the cases in order to arrive at their general theory of contract, and he offered competing readings of several leading cases to justify his viewpoint. See Grant Gilmore, *The Death of Contract* 24 (2d ed. 1995). Gilmore's history and theory have become objects of routine disparagement, but Gilmore's first calling was literary criticism, and his insights into the Nietzschean mode by which the classical interpretation of contract became dominant, and its violence in ousting previously popular interpretations of contract, remain salient. By subjecting the cases to a rereading, and by emphasizing how controversial the classical interpretations and classifications of the cases were when they appeared, Gilmore reminds us of the creative power of classical theorizing.

<sup>18</sup> One of the important parts of such a view of contract would be some account of how potential regulation works, not only when the potential is exercised, but also when it remains in the shadows, since the refusal of the state to exercise power over a given relationship allows whoever wields power within the relationship to violate the relationship's norms with impunity.

<sup>19</sup> At least one scholar has made the case that the best reading of the history of contract should place the fairness of distribution at its center, while retaining the focus on promise enforcement. See James Gordley, "Enforcing Promises," 83 *Cal. L. Rev.* 547, 548 (1995).