

HEINONLINE

Citation: 2004 Wis. L. Rev. 631 2004



Content downloaded/printed from
HeinOnline (<http://heinonline.org>)
Sun Sep 7 01:28:42 2014

- Your use of this HeinOnline PDF indicates your acceptance of HeinOnline's Terms and Conditions of the license agreement available at <http://heinonline.org/HOL/License>
- The search text of this PDF is generated from uncorrected OCR text.
- To obtain permission to use this article beyond the scope of your HeinOnline license, please use:

[https://www.copyright.com/cc/basicSearch.do?
&operation=go&searchType=0
&lastSearch=simple&all=on&titleOrStdNo=0043-650X](https://www.copyright.com/cc/basicSearch.do?&operation=go&searchType=0&lastSearch=simple&all=on&titleOrStdNo=0043-650X)

RELATIONAL CONTRACTS AND THE NEW FORMALISM

WILLIAM C. WHITFORD*

I. INTERNATIONAL AGREEMENTS

This Comment originated as a response to the article by Professors Robert Scott and Paul Stephan that applies contract theory to international agreements.¹ Scott and Stephan's article is an unusual application of contract theory, though not an implausible one. Unfortunately, my knowledge of international agreements is limited. I am not versed in the literature, nor do I have any practical experience in this area. It is my belief that Scott and Stephan have made a plausible case that providing for coercive enforcement in international agreements can deter—*crowd out*—reliance on self-enforcing remedies, with deleterious consequences.

It is worth noting that in reaching this conclusion, the authors classify the World Trade Organization (WTO) dispute-resolution process as a self-enforcing mechanism. Because the WTO occupies increasing importance in the world of international agreements, this classification is important to their conclusion that the parties to a considerable majority of international agreements choose to avoid coercive enforcement. It is a classification that they make even though the WTO dispute resolution process has many aspects of coercive enforcement. The decisions are reached by independent individuals, not selected by the countries affected, and those decision-makers apply a procedure and an analytical reasoning methodology that looks very much like adjudication.² The authors nonetheless classify WTO dispute resolution as self-enforcing for two reasons. First, the adjudications are not considered binding in international law because no court can directly apply sanctions for disobedience of the judgments. Second, Scott and Stephan identify as a critical characteristic of coercive enforcement in international agreements the ability of nonparties to the agreement to initiate action to compel compliance when they are adversely affected by a breach of the agreement.³ Under the WTO, only the signatory countries can initiate the dispute settlement process.

* Emeritus Professor of Law, University of Wisconsin Law School. I am grateful for helpful comments on earlier drafts from Neil Komesar, Stewart Macaulay, Josh Whitford, and Erik Olsen.

1. Robert E. Scott & Paul B. Stephan, *Self-Enforcing International Agreements and the Limits of Coercion*, 2004 Wis. L. REV. 551.

2. See GREGORY C. SHAFFER, *DEFENDING INTERESTS: PUBLIC-PRIVATE PARTNERSHIPS IN WTO LITIGATION* 5, 8 (2003) (noting that the WTO dispute settlement proceedings, though technically initiated by governmental bodies, frequently result from initiatives by private parties, who form 'public-private' partnerships).

3. See Scott & Stephan, *supra* note 1, at 592.

Scott and Stephan might be read as making a secondary claim implicitly—that we can learn something about commercial agreements from international agreements. If it makes sense in international agreements to avoid legal enforceability to preserve more scope for self-enforcement, then perhaps we should be more open to a similar conclusion in commercial agreements. This argument is not a claim made explicitly, and I do not know that the authors intended to make it. In any event, I would counsel care in applying lessons from international agreements to most commercial agreements. There are just too many differences in the contexts in which the two kinds of agreements take place. One example derives from the last point made in the preceding paragraph: in international agreements, it is apparently sensible to regard agreements where third-party beneficiaries have no enforcement rights as self-enforcing. But a similar conclusion would not be made with respect to commercial agreements, where there are normally many nonsignatory parties adversely affected by nonperformance of an agreement who cannot initiate enforcement (for example, employees and suppliers).⁴

For another example of the differences that should caution against quickly drawing analogies between international and commercial agreements, consider the claim of Scott and Stephan that regimes (basically the management of countries) have an aversion to appearing submissive and hence have a strong preference for self-enforcement of international agreements.⁵ I doubt that this aversion to appearing submissive to law generally applies in the private sector. On the contrary, the agents representing commercial parties may often prefer to be able to say that the action is compelled by law and hence is not the discretionary decision of management when they must disappoint an important constituency (for example, a department within the firm or shareholders) in taking particular action with respect to a contract.⁶

4. See E. ALLAN FARNSWORTH, *CONTRACTS* § 10.1, at 672 (3d ed. 1999) (“The performance of a contract usually benefits persons other than the parties who made it, but they cannot ordinarily enforce it.”); see also *N. Ind. Pub. Serv. Co. v. Carbon County Coal Co.*, 799 F.2d 265, 280 (7th Cir. 1986) (“As for possible hardships to workers and merchants [in the seller’s locale], we point out that none of these people were parties to the contract with [the buyer] or third-party beneficiaries. They have no legal interest in the contract.”).

5. Scott & Stephan, *supra* note 1, at 616.

6. See Lauren B. Edelman et al., *Professional Construction of Law: The Inflated Threat of Wrongful Discharge*, 26 *LAW & SOC’Y REV.* 47, 49 (1992) (finding that with respect to the doctrine of wrongful discharge, “the legal and personnel professions act as ‘filters’: they construct not only the meaning of law but also the magnitude of the threat posed [to an employer] by law”).

II. ROBERT SCOTT AND THE NEW FORMALISM

Most of this Comment will be directed to the contract theory portion of the principal article. That discussion is derivative of a major article recently published by Scott in the *Columbia Law Review*.⁷ In that article, Scott more fully describes the norm of reciprocal fairness and the evidence of its existence, and then suggests various applications to commercial agreements.⁸ These suggestions include a revival of the indefiniteness doctrine, by which a court refuses to enforce an agreement in which the parties leave important gaps.⁹ Scott's article is part of a series of recent articles in which Scott advocates a set of related propositions that I will call collectively the new formalism. Other positions that he has taken include advocacy of a strict application of the parol evidence rule coupled with zealous adherence to the plain meaning in the interpretation of express contract language.¹⁰ And Scott is one of the leading critics of the so-called "incorporation idea," by which courts are encouraged to look to trade custom to fill gaps in agreements and as a guide to the interpretation of express contract language.¹¹

Before commenting specifically on Scott's new formalism, it is appropriate that I reflect more generally on Scott's career in contract law. He is obviously one of the giants of his generation, as recognized in a recent special issue of the *Virginia Journal*.¹² I have long admired him, and welcomed his contributions, for many reasons but one reason above all: Scott is the member of the law-and-economics community who has taken most seriously the concerns of a group of scholars, sometimes described as relational contracts theorists, with whom I identify.¹³ Scott was among the

7. Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641 (2003) [hereinafter Scott, *Indefinite Agreements*].

8. *Id.* at 1645.

9. *Id.* at 1685-92.

10. See Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 847-48 (2000) [hereinafter Scott, *Formalism*].

11. See generally Robert E. Scott, *The Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies*, in THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 149 (Jody S. Kraus & Steven D. Walt eds., 2000); Robert E. Scott, *The Rise and Fall of Article 2*, 62 LA. L. REV. 1009, 1038 (2002). For a useful and recent summary of Scott's work on interpretation of contracts, see Clayton P. Gillette, *The Perils of Article 2: Strategies of Interpretation*, 6 VA. J. 38, 38-42 (2003).

12. *Festschrift to Charles J. Goetz and Robert E. Scott*, 6 VA. J. 1 (2003). The volume contains a short article by Scott himself summarizing the positions that he has recently taken, which I describe as the new formalism. Robert E. Scott, *Rethinking the Default Rule Project*, 6 VA. J. 84, 84 (2003) [hereinafter Scott, *Default Rule Project*].

13. I will frequently refer to "relational contract theory" in this Comment. Stewart Macaulay and Ian Macneil are commonly associated with this group and identified as leaders, but of course there are many others—so many that I will not risk the sin of omission by trying to identify them. There is no uniformly accepted statement of what this

first to recognize that in relational contracts between commercial firms, the parties' desires for and expectations of continuing relations can complicate the contract formation process in ways that the law must take into account. In particular, an agreement occurs in stages and performance commonly begins before the final stages of the agreement process, creating various problems not well accommodated by traditional contract doctrine.¹⁴ Scott has also been one of the members of the law-and-economics community who has most enthusiastically explored the utility for contract theory and doctrine of what he calls "heuristics"—essentially the tendency of some people to prefer something other than material wealth maximization in their decision-making. Consequently, models built on rational maximization of wealth do not always mimic the desires or behaviors of contractual parties.¹⁵ In the article on which I am commenting, and the article in the *Columbia Law Review* on which it is based, Scott explores the idea of what he calls reciprocal fairness as a source of human motivation. Scott goes to great length to demonstrate that a taste for reciprocal fairness can be a sensible part of an overall strategy to maximize wealth, and indeed it can, as has been demonstrated by many laboratory studies based on the prisoner's dilemma paradigm for bargaining choices.¹⁶ But reciprocity is also a core idea in seminal anthropological and sociological works about long-term relationships and communities, where a tradition of reciprocity is seen as a key strategy for preserving community, which in turn is identified as an end in itself or as a means to some goal like happiness and fulfillment that is independent of wealth maximization.¹⁷

While Scott has been receptive to ideas from relational contract theory, in his recent work developing what I have called the new formalism, he has strayed from relational contract theory in a critically important way. In the balance of this Comment, I hope that I can convince him to come back to the relational-contract reservation.

theory entails, but I mean to incorporate the main ideas of Macaulay and Macneil in my use of this phrase. My understanding of these ideas is discussed in William C. Whitford, *Ian Macneil's Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 545, 545–55. For further discussion of the relational theory of contracts, see generally DAVID CAMPBELL, *THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL* (2001).

14. See generally Charles J. Goetz & Robert E. Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967 (1983); Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981).

15. See Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2006–07 (1987).

16. See Scott, *Indefinite Agreements*, *supra* note 7, at 1674–75; Scott & Stephan, *supra* note 1, at 565–67. Scott has summarized at great length the results of laboratory studies of reactions to prisoner's dilemma games. See Scott, *Indefinite Agreements*, *supra* note 7, at 1661–66, 1670–72.

17. For a classic statement of this proposition in an anthropological context, see BRONISLAW MALINOWSKI, *CRIME AND CUSTOM IN SAVAGE SOCIETY* 24–25 (1926). For a review of the anthropology literature on primitive societies, see MARSHALL SAHLINS, *STONE AGE ECONOMIES* 191–275 (1972).

III. THE NEW FORMALISM, RELATIONAL CONTRACTS, AND *EX ANTE* EFFICIENCY

There is nothing in relational contract theory that should cause its adherents to reject formalist contract doctrine in all circumstances. Relational contract theory does indicate, however, that formalist contract doctrine is not an effective way to achieve the goal that Scott states would be best served by his new formalism. Scott has been very clear that economic efficiency should be the dominant goal of contract law. By far the most important orientation in assessing what is efficient, in Scott's eyes, is what he calls *ex ante* efficiency.¹⁸ In formulating contract doctrine, he wants us to keep primarily in mind the world of the contract drafter. He wants rules for solving contract disputes that help and encourage the contract drafter to make the most efficient decisions about what terms to include in the contract.¹⁹ Predictability of possible future court decisions, presumed by Scott to be best served by his new formalism, facilitates such decision-making.²⁰

This simple statement of benefits of formalism as seen by Scott does not do justice to the sophistication with which he has advanced his argument. I refer the reader to his articles for more discussion. There is a great deal of insight worth absorbing, including distinctions drawn between both rules and contract terms that depend on what he calls verifiable or nonverifiable and observable or nonobservable information. The zeal with which Scott identifies *ex ante* efficiency as his primary concern is indicated by recent advocacy of what he calls information-forcing rules. Information-forcing rules are those that create incentives for parties to negotiate contract provisions that, in a doctrinal world governed by a plain-meaning rule, can be applied in a predictable way. With respect to the indefiniteness doctrine, whose more frequent application is advocated by Scott in the article in *Columbia Law Review*,²¹ this incentive is provided by withholding enforceability unless the parties negotiate contract terms that can be applied predictably.

18. Scott, *Formalism*, *supra* note 10, at 849 (“[E]x ante efficiency[] . . . is designed to protect (and even improve) the utility of the set of contractual signals for future parties.”).

19. See Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *YALE L.J.* 541, 556 (2003) (“[O]ur principal normative claim [is] that contract law should facilitate the ability of firms to maximize welfare when making commercial contracts.”).

20. *Id.* at 569 (“[F]irms prefer courts to make interpretations on a narrow evidentiary basis whose most significant component is the written contract.”).

21. See Scott, *Indefinite Agreements*, *supra* note 7, at 1647, 1687 (arguing that “the theory of reciprocal fairness supports adherence to the common law indefinite doctrine,” which is that a contract is unenforceable unless it is “certain and definite such that [the parties’] intention may be ascertained with a reasonable degree of certainty”).

The difficulty that I have with Scott's almost exclusive focus on how contract rules can increase *ex ante* efficiency is that I do not think it is possible to have much influence on the behavior of parties in the formation stage of relational contracts simply by manipulating the rules for adjudicating any subsequent litigation. I have two basic reasons for this conclusion.

First, the contract formation stage provides the setting for a tremendous amount of performance planning within a large enterprise. Much of this planning that must take place requires coordination between departments—between production, finance, shipping, and purchasing, for example—and there will often be disagreements about what should be done. This provides a setting for what I will call *intrafirm politics*. Because firms have a hierarchical management structure, there will be a corporate officer with authority to make a binding decision when heads of departments disagree. But acting in that manner may not be wealth maximizing or efficient for the firm. For example, it can cause hard feelings, which might be deleterious to employee morale, or it may motivate a key employee to accept an opportunity elsewhere. In these circumstances, the wise course may be a vague contract provision that equivocates with respect to the issue at hand. If the provision concerns a contingency, the contingency might never ripen. If it concerns something that must be decided in the course of performance, a decision at a later time might be less disruptive to *intrafirm politics*. Perhaps by then a key employee will have retired and that will make resolution of the *intrafirm* disagreement easier.²²

Second, the formation stage of a relational contract between commercial entities is also a time when the two enterprises seek to build trust between themselves. Professor Omri Ben-Shahar's paper in this Symposium discusses why trust-building concerns might cause parties who are maximizing their wealth to avoid specification of a term at the time of contract formation.²³ These concerns are similar to the ones that arise in what I have called *intrafirm politics*. If the parties can delay a decision, then it may be clear that a contingency will not happen, or a key individual may retire or be reassigned. Perhaps most importantly, as the relationship

22. Professor George Triantis has offered other explanations for why vagueness may serve firm maximization goals. See George G. Triantis, *The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2*, 62 LA. L. REV. 1065, 1076-78 (2002). Triantis also has offered an agency cost explanation for why vague terms may appear in contracts negotiated by large firms. Even when specification may be in the firm's interest, the decision-making official in a firm may have a career related reason (most likely, enhancement of personal reputation) to want to close the deal and prefer a vague term for fear that attempting to specify a term may reveal unbridgeable disagreement, either within that particular firm or between firms. See *id.* at 1067 ("Agents may . . . prefer[] to avoid the risk of a deal-breaking negotiation over a specific contingency and to accept instead the risk of a protracted and uncertain litigation.").

23. Omri Ben-Shahar, *"Agreeing to Disagree": Filling Gaps in Deliberately Incomplete Contracts*, 2004 WIS. L. REV. SSS, 389, 407-08.

between the firms deepens and becomes more involved, new issues are likely to arise, providing opportunities for bargaining trade-offs that were not apparent at the time of original contract formation and that leave each party feeling positive about the deal. What I want to stress is that delay in specification of contractual terms for these reasons can be maximizing for both firms. In many businesses, profitability is best served by establishing long-term relationships involving repeated contracts with suppliers and customers. Establishment of long-term relationships not only introduces efficiencies in subsequent contract formation, because course-of-dealings can be incorporated as implicit terms, but as confidence in the continuation of the relationship is established, one finds precontract reliance in the form of idiosyncratic investments in contemplated transactions—for example, a build-up of inventory in a nonfungible good.²⁴

In sum, insisting on negotiating detailed, determinate contract terms at the formation stage of a relational contract raises a can-of-worms problem. Insisting on bargaining out differences can lead to stalemate, causing negotiations to flounder, with tremendous resulting opportunity losses. In Scott's own work, and in related work by others in the law-and-economics tradition, concern is expressed about the costs to the parties of bargaining over the kind of precise contractual terms that Scott favors and seeks to encourage—what are sometimes called the “specification” costs in the literature. If these costs are too high, it is recognized that the parties have an incentive to leave gaps in the contract, or to choose terms phrased vaguely so that there are not predictable outcomes if those terms were to be litigated.²⁵ In relational contracts, these specification costs are much higher than is usually recognized because of the opportunity costs, or indirect costs of specification. Negotiations about specific contract terms can take the focus away from what is most important at this time—performance planning within each firm and building trust between firms.

24. There is extensive literature in organizational sociology on *networking* as the emerging industrial paradigm, thereby replacing the vertically integrated firm. Networking includes the formation of relational contracts, and there is a good deal of emphasis in this literature on the advantages of this kind of contracting as contrasted either with spot contracting or a vertically integrated firm. Contracts literature has not made frequent reference to this literature in sociology, but it should because it provides a rich empirical basis for its conclusions. For a review of this sociological literature, see Walter W. Powell, *The Capitalist Firm in the Twenty-First Century: Emerging Patterns in Western Enterprise*, in *THE TWENTY-FIRST-CENTURY FIRM: CHANGING ECONOMIC ORGANIZATION IN INTERNATIONAL PERSPECTIVE* 33, 35–36 (Paul Diaggio ed., 2001); and Joel M. Podolny & Karen L. Page, *Network Forms of Organization*, 24 *ANN. REV. SOC.* 57, 58–89 (1998).

25. See Juliet P. Kostritsky, *Taxonomy for Justifying Legal Intervention in an Imperfect World: What To Do When Parties Have Not Achieved Bargains or Have Drafted Incomplete Contracts*, 2004 *WIS. L. REV.* 323, 327–28; Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 193, 193 (Jody S. Kraus & Steven D. Walt eds., 2000).

And what is the gain that might justify incurring high specification costs? The gain offered by specific contract terms of the type that Scott favors is a preferred result if litigation were to ensue. We must always remember that litigation is the proverbial tip of the iceberg. Since it is something like ten percent of an iceberg that is above water, even that metaphor overemphasizes the importance of litigation; a much smaller percentage of agreements end up in litigation.²⁶ So the potential gain to the parties of specifying all obligations in detail and with clear language is slight.²⁷ I conclude that in relational contracts, it is not possible to offer the parties enough advantage by manipulating the rules governing dispute settlement to affect behavior at the time of formation in a very significant way. The costs to the parties of behaving differently than they otherwise would to gain some advantage in litigation are simply too great.

I do not want to exaggerate because it is not my position that there are never contracts in which the parties at the time of formation devote substantial attention to planning for possible litigation. In those circumstances the formulation of contract law rules can impact behavior at the formation stage. Probably the most common situation where litigation planning looms large in contract drafting is in preparation of standard forms, which are commonly used in relational contract situations (for example, purchase orders), as well as in consumer contracts. Where a form will be used repeatedly, the specification costs can be spread over many contracts. And where the nondrafting party is not expected to pay much attention to the content of the form, there may be few indirect specification costs as well, since use of the standard forms will not interfere with trust-building activities. But it is not primarily standard form contracts that Scott has in mind when he advocates a return to formalism to enhance *ex ante* efficiency. He is concerned to influence the drafting of bargained (or “dickered”) terms in firm-to-firm contracts.²⁸

26. Because of bargaining in the shadow of the law, the correct measure of potential leverage on the parties at the time of formation that can be exerted by manipulating the rules for dispute settlement is greater than the percentage of total contracts that end up in litigation. It includes those contract disputes that lead to termination of an ongoing relationship, and the resulting settlement is influenced significantly by how litigation would come out.

27. It must be remembered that even if the parties do bargain a complex and specific set of terms, it is likely that many of those terms will be consensually modified before being applied, further reducing the payoff for incurring specification costs at the time of formation. See Stewart Macaulay, *Freedom from Contract: Solutions in Search of a Problem?*, 2004 WIS. L. REV. 777, 800 n.83 (quoting JERRY ADLER, HIGH RISE: HOW 1,000 MEN AND WOMEN WORKED AROUND THE CLOCK FOR FIVE YEARS AND LOST \$200 MILLION BUILDING A SKYSCRAPER 206 (1993)).

28. See *supra* text accompanying notes 18–21. The standard forms that are exchanged in relational contract context—for example, purchase orders, acknowledgement of orders—are part of what my colleague, Stewart Macaulay, calls the paper deal, not the real deal. The boilerplate in those forms will be routinely ignored in the course of performance and insisted upon, if at all, only in those rare circumstances when litigation

IV. ALTERNATIVES TO A GOAL OF *EX ANTE* EFFICIENCY

If my analysis has been correct, then *ex ante* efficiency is not a sensible goal for the formulation of the contract rules governing dispute settlement. If the ability to impact *ex ante* efficiency is limited, then we should focus more on *ex post* concerns. There are at least four categories of *ex post* concerns: (1) what I will call *ex post* efficiency—basically limiting the direct costs of dispute settlement; (2) what I will call autonomy—basically reaching a result not inconsistent with the parties' *ex ante* intentions; (3) distributional concerns; and (4) public policy concerns not related directly to the parties' welfare. I will only comment on the first two concerns.

A. Ex Post Efficiency

Law-and-economics analyses commonly assume that highly determinate or predictable rules for dispute settlement lead to more and quicker settlements and reduced litigation costs.²⁹ Scott has argued that standards also produce more disputes than bright-line rules, because they invite parties opportunistically to convince a court that performance is excused when the real reason for wanting out of a contractual commitment is simply because of an adverse turn in the market.³⁰ Determinate legal rules, making clear that no excuse will be found in such circumstances, might discourage such opportunistic breaches.³¹ This proposition may have validity with respect to some kinds of contracts, but I question its applicability to relational contracts. In the world of relational contracts, litigation usually occurs only after the relationship is irretrievably broken. In a situation where the parties have the prospect of a continuing relationship, rarely does a party resort to litigation just to take some opportunistic advantage of a vague contract provision or default rule. Such breaches are not likely to go unnoticed in the relevant industry, and a fear of consequent reputational sanctions deters opportunistic breach and litigation.

Perhaps a case, though not an uncontestable one, can be made for formalism with respect to relational contracts, if one is willing to elevate *ex*

results after a breakdown in the relationship, caused usually by something other than content of or inconsistencies between standard forms. See Stewart Macaulay, *The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules*, 66 MOD. L. REV. 44, 45–47 (2003).

29. See George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. LEGAL STUD. 1, 4 (1984).

30. See Schwartz & Scott, *supra* note 19, at 603 (“When a standard governs, the party who wants to behave strategically must ask what a court will later do if the party is sued. The vaguer the legal standard and the more that is at stake, the more likely the party is to resolve doubts in its own favor.”).

31. See Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 766–69 (2000).

post efficiency concerns over all other values and if one assumes that determinate rules reduce litigation costs. I think the latter assumption requires more qualification, but that discussion is beyond the scope of this Comment. I am also unwilling to give such priority to *ex post* efficiency concerns.

B. *Autonomy*

Autonomy concerns have a relationship to efficiency concerns. The normative basis of autonomy values is freedom of contract. In our culture we value allowing citizens to live their lives and do with their property as they please. The ideal of freedom of contract is part of that overarching vision. I am a follower of Ian Macneil, and I do not concede efficiency analysis reveals all that parties to commercial contracts seek to achieve.³² But efficiency analysis is certainly a good place to start to figure out what the parties probably intended, or would have intended if they thought about it, in a case where the contract language does not fully settle the question of what the parties intended. Efficiency encompasses major objectives of the parties to the contract, and in many cases by far the most important objectives. That is the proper basis, in my judgment, for using efficiency analysis to help devise majoritarian gap-filling default rules.³³

Autonomy concerns are a fit place to revisit Scott's advocacy of a reinvigorated indefiniteness doctrine. Scott and Stephan argue that in international agreements, a presumption against coercive enforcement is most likely to be consonant with the parties' intentions because of their preference for self-enforcement and fear that the availability of coercive enforcement will *crowd out* self-enforcement mechanisms. The argument is plausible in that context and consistent with autonomy values. There are also commercial situations where indefiniteness, or perhaps an *agreement to agree*, suggests a mutual understanding that there is no liability until later agreement,³⁴ and there is nothing in autonomy values that would argue for enforcement when in such contexts negotiations break down before the subsequent agreement.

Scott argues that respect for norms of reciprocal fairness and concerns about *crowding out* resort to informal settlement should make courts more willing to presume a lack of intent to be bound in commercial agreements. There may be some merit to this view with respect to one-shot transactions between strangers. But I am dubious that respect for reciprocal fairness

32. See Whitford, *supra* note 13, at 549-55.

33. See Kostritsky, *supra* note 25, at 325-26.

34. I am among those who think the agreement between Getty Oil and Pennzoil, which was the focal point of the litigation in *Texaco, Inc. v. Pennzoil, Co.*, 729 S.W.2d 768, 805-09 (Tex. Ct. App. 1987), should have been viewed as unenforceable for this reason.

norms should carry much weight in evaluating the intent of the parties when relational contracts breakdown. Retaliatory and reputational sanctions are very strong and pervasive when one party backs out of a relational contract.

As a result, self-enforcement of relational contracts is the norm. There is no need at the time of formation to presume a shared acceptance of norms in order to justify self-enforcement as the presumed course of performance.

Equally important, when self-enforcement fails and litigation results, there has usually been considerable performance on both sides. By that time, idiosyncratic investments have likely been made, meaning that one party (and maybe both) has invested in anticipation on the continuation of the relationship in a way that they cannot easily mitigate once the deal falls through. Absent the availability of a judicial remedy, unequal idiosyncratic investments create *ex post* well-known incentives for opportunistic behavior where one party drives a very hard bargain in return for not calling the deal off. It is hard to imagine that the parties intended such a result at the time of formation. Like Professor Juliet Kostritsky,³⁵ I find that providing a judicial remedy in such circumstances more consistent with autonomy concerns. The moral hazard problem here is created not by relying on a standard to provide for a judicial remedy, as Scott fears,³⁶ but by failing to provide a judicial remedy at all.³⁷

This autonomy-based justification for judicial gap filling of indefinite contracts depends on one final point. Over the years, Scott and others have expressed great concern about error costs in judicial decisions.³⁸ From the perspective of autonomy values, error costs arise when a court interprets a contract inconsistently with the parties' intentions. Such decisions fail to

35. Kostritsky, *supra* note 25, at 328–29.

36. *See supra* text accompanying notes 30–31.

37. Scott may implicitly recognize this point when, in an unemphasized footnote, he allows for restitution and reliance damage remedies in such circumstances, even while advocating that courts use the indefiniteness doctrine to bar expectation damages. Scott states:

[My] general proposition [favoring non-enforcement of indefinite contracts] is qualified to the extent that the agreement has been partially executed by the promisee. In that case, general principles of restitution may support a recovery on the basis of quantum meruit. . . . Moreover, a few courts have granted relief on the basis of promissory estoppel where the facts show a specific inducement by the promisor.

Scott, *Indefinite Agreements*, *supra* note 7, at 1643 n.7 (citation omitted). A legal realist might argue that a judge armed with promissory estoppel and with quantum meruit remedies can do almost anything she could with expectation damages. Reliance damages applied creatively to include recovery of opportunity costs may not be much different from expectation damages subject to a mitigation principle.

38. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261, 267–73 (1985); Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 273–74 (1992); Scott, *Formalism*, *supra* note 10, at 865.

implement the expectations that the parties formed at the time of formation and are a legitimate autonomy concern. If error costs are too high, then it may be more consistent with autonomy values to adopt Scott's new formalism, despite my belief expressed above, that this approach does not necessarily reflect the parties' intentions in relational contracts.³⁹

The empirical question is whether error costs are high. It is certainly the case that in a doctrinal world riddled with standards rather than determinate, bright-line rules, the outcome of a particular case will be determined in part by which judges are assigned to it and hence will not be totally predictable. If one assumes that there is a single correct decision to each case, then it follows that many decisions must be erroneous. Very frequently, however, from an autonomy perspective, there is not a single correct answer to a case. The best one can do is rule out a range of solutions to the dispute. There remains another range of solutions that are plausibly consistent, or at least not inconsistent, with the parties' inchoate intentions (sometimes called tacit assumptions). From this perspective, the incidence of clear error in judicial decision cannot be measured simply from a variance in result in similar fact situations.

The contracts literature at present is filled with assertions that error costs are high,⁴⁰ or alternatively that we can have confidence in the discretionary decisions of judges.⁴¹ We should not be content with countervailing assertions. The incidence of error and the resulting costs are a matter that requires serious empirical study. Admittedly, the design and implementation of good empirical studies is difficult. Victor Goldberg's intensive studies of particular famous decisions, though not producing statistics, is one place to start.⁴²

39. See Kraus & Walt, *supra* note 25, at 216 (justifying Llewellyn's incorporation strategy for gap filling if error costs are less than the parties' specification costs would be if they solved all problems by negotiating determinate contract provisions). But see Gillian K. Hadfield, *Judicial Competence and the Interpretation of Incomplete Contracts*, 23 J. LEGAL STUD. 159, 164 (1994); Posner, *supra* note 31, at 762-69, 773-74 (arguing that courts should enforce incomplete contracts even assuming radical judicial incompetency, providing that the parties intended to form a legally enforceable contract).

40. See authorities cited *supra* note 38.

41. See, e.g., Peter Linger, *Rough Justice: A Theory of Restitution and Reliance, Contracts, and Torts*, 2001 WIS. L. REV. 695; Leon Trakman, *The Effect of Illegality in the Law of Contract: Suggestions for Reform*, 55 CAN. B. REV. 627, 652-54 (1977).

42. E.g., Victor P. Goldberg, *Bloomer Girl Revisited or How to Frame an Unmade Picture*, 1998 WIS. L. REV. 1051, 1051-53 (discussing *Parker v. Twentieth Century-Fox Film Corp.*, 474 P.2d 689 (Cal. 1970), and concluding that the court reached the right result from the perspective of autonomy values, though providing the wrong reasons for their result); Victor P. Goldberg, *In Search of Best Efforts: Reinterpreting Bloor v. Falstaff*, 44 ST. LOUIS U. L.J. 1465, 1465-66 (2000) (discussing *Bloor v. Falstaff Brewing Corp.*, 601 F.2d 609 (2d Cir. 1979), and concluding that the district court did not reach the correct result).

V. CONCLUSION

Scott has been a leader among a group of scholars who have advocated a new formalism, which is essentially a return to neoclassical formalism, in contract law. These scholars argue that efficiency goals would ordinarily be best served if contractual parties specified with precision contractual terms at the time of formation that will maximize the wealth gains from their joint activities. And they argue that formalist contract doctrine, including a plain meaning rule, a strict parol evidence rule, and revival of the indefiniteness doctrine, will provide contractual parties with incentives so to specify terms.

I have argued that with respect to relational contracts between firms, this argument overlooks a fundamental insight into contracting practices that was identified long ago. Firms are sensibly more interested at the time of contract formation in performance planning and building trust between themselves than they are in planning or specifying what rules should be applied in the event their relationship should terminate in litigation. Manipulating rules applied only in the event of litigation is simply not an effective way to provide contractual parties an incentive to do much of anything at the time of contract formation. This reality leads me to favor application in litigation of the contextualist and gap-filling contract rules that Scott and other new formalists have criticized. These rules enable a court to approximate more closely the results the parties probably would have agreed to at the time of formation if they had thought about it and taken the time to specify their conclusion.

* * *