

The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules

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Assume that contract law matters, at least in some subset of all the situations where people consider making or do make contracts. Also assume that contract law should rest to a large extent on choice or responsibility for misleading others about one's choices. Making these assumptions, we must be concerned with how the legal system deals with the expectations of the parties. One approach is formal. Judges can limit themselves to dealing with only the formal expressions of the parties - the paper deal. They need ask only whether the parties signed or accepted a document, and if they did, what is the 'plain meaning' of the words they used. Sometimes, writings labeled 'contract' do capture many if not most of the expectations of those who sign them.

Often, however, the paper deal will not reflect the real deal: a writing can be inconsistent with the actual expectations of the parties. Courts frequently have sought to protect such actual expectations despite the presence of a writing that does not mention them or even one that is inconsistent with them. However, establishing real expectations often is very difficult. Courts face what Richard Danzig has called 'the capability problem.'¹ Some expectations, for example, are only tacit assumptions - what I would have said if I had thought about a question that I did not think about. Even if the parties did have real expectations that they did not express in their written document, we must worry that today's testimony about them will be self-serving and fabricated to make the case come out the right way. Also, proving the real deal often will be very costly. The parties must convey a commercial context to a judge or to jurors. They may come to the task with little, if any, knowledge of the part of the business world in question. Experts can inform them, but experts are not free.

If we want our courts to carry out the expectations of the parties to contracts, both those that they express in writing and those that are left unrecorded or even unspoken, we must accept a contract law that rests on standards rather than on clear, quantitative rules. Contract law then will talk of 'good faith', 'duties of cooperation', or 'within limits set by commercial reasonableness.'² Others have written much about what standards are most appropriate.³

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1 R. Danzig, *The Capability Problem in Contract Law* (Mineola, NY: Foundation Press Inc., 1978).

2 See, eg, Uniform Commercial Code §2-311(1): 'An agreement for sale which is otherwise sufficiently definite ... to be a contract is not made invalid by the fact that it leaves particulars of performance to be specified by one of the parties. Any such specification must be made in good faith and within the limits set by commercial reasonableness.'

However, there are objections to writing contract law in the qualitative fashion that seems necessary that are so well known that we can call them classic. Furthermore, there are also classic responses to these objections.⁴ In this paper I will ask whether we can do more than just reprise these old songs and hear one group of scholars, judges and lawyers sing one song while another group whistles the other. We can clarify our choices by examining each from a law and society perspective - that is, by asking how the law in action appears from the point of view of business people and their lawyers. Moreover, we can gain a little ground in at least one limited subset of contract cases if we focus on judges in such disputes serving as agents of settlement. With all of its flaws, such coerced cooperation may be the least bad solution in many situations.

I will review briefly some of the reasons that the paper deal often does not reflect the real deal or the implicit dimension of contract. I will consider the somewhat chaotic responses American courts have given to the problem. I will look at what relational contract theory suggests courts should do and what a concern about the rule of law offers. My conclusion is not startling: we cannot have our cake and eat it too. There are costs and benefits flowing from focusing on the paper deal and from focusing on the real deal. The twentieth century history of American contract law and scholarship reflects cycles of privileging one judgment about those costs and benefits and then rejecting it and adopting another. Finally, I will suggest that in a limited subset of all contract cases, we should be content with almost any approach that leads to settlements that give expression, more or less, to relational norms and values.

The gap between the real deal and the paper deal

Things are easier for some parties and courts if the legal system focuses entirely on any written document that the parties have signed or accepted. If legal agencies do this consistently, corporate lawyers, for example, need worry less about what their client's sales people say or do. However, this approach requires courts to close their eyes to real expectations resting in the implicit dimensions of contract and significant reliance on them. Contracts are always more than the contract document. We have long known the many reasons for this: Words do not have a fixed meaning that every speaker of the language will translate the same way. We create the meaning of written language by bringing to the words some measure of

³ D. Campbell, 'Reflexivity and Welfarism in the Modern Law of Contract' (2000) 20 *Oxford Journal of Legal Studies* 477, 497, notes that much American writing on contracts, except that of Ian Macneil, criticises classical contract law but fails to set out a rival theory. I have said: 'people should not attempt to write about contracts until they have studied Macneil.' S. Macaulay, 'Relational Contracts Floating on a Sea of Custom? Thoughts About the Ideas of Ian Macneil and Lisa Bernstein' (2000) 94 *Northwestern University Law Review* 775, 776. Nonetheless, I am skeptical about whether anyone can create a complete rival theory applicable to all kinds of contracts without a good deal of oversimplification. I also doubt that any such grand rival theory could be sold to the judges and lawyers who would have to put it into practice. See J. M. Feinman, 'Relational Contract Theory in Context' (2000) 94 *Northwestern University Law Review* 737. I would be pleased to be proven wrong. My contribution, if any, will be only to look at proposals and arguments advocating positions and to ask whether they seem compatible with business practices about which I know something. Pointing out over generalisations and questionable assumptions is still valuable work.

⁴ The best discussion of these classic pro and con arguments is D. Kennedy, 'Form and Substance in Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685.

context, background assumptions, our experiences, and, too often, our bias, ignorance and stupidities.⁵

Also, it is very hard to bring the future to the present and provide that X will happen if event Y takes place.⁶ Our ability to predict the future is limited, and even careful business people often leave gaps in written contracts. The world changes and surprises us: Wars break out in places where we do not expect them; or our contract may have dealt with a war but left open what happens when the indirect effect of a major terrorist attack makes performance much more costly; OPEC drives up energy costs unexpectedly; new technologies, often involving computers, change things so that an older contract no longer makes sense.

Even when we can foresee that it is possible that something might happen, there are limits on the time that we can or should spend on trying to provide for all contingencies in our contracts. In most instances, it would not pay to hire enough people with the skill needed to review what is printed in fine print on the back of various sellers' forms such as proposals, acknowledgment of orders and invoices. A firm that is filling thousands of purchase orders every week could not afford to take the time to negotiate all the details of every transaction. Moreover, as Tom Palay notes: 'looking beyond the [written] contract is important because parties who have, or anticipate, strong relational ties with their contracting opposites are not particularly worried about initial terms of agreement.'⁷ In many situations careful contract negotiation signals distrust when the situation calls for a business marriage.

Furthermore, we must remember that business corporations are collections of people and their activities are seldom tightly coordinated. Those who negotiate the deal often are not the people who draft the written document recording it. Still others must perform the contract. This opens the possibility that, for example, a firm's lawyers may have different assumptions and expectations than its purchasing agents, sales people, and engineers.

Strategy may be involved too. If I want a clause that says if event X takes place, then consequence Y will follow, you may demand something in exchange that I do not want to give you. When I anticipate this, it may be better to avoid raising the issue in negotiations and hope that the matter can be resolved if event X ever takes place.

Lawyers deal with many of these problems by fabricating detailed standard form contracts that typically are written in legal or technical language that 'is not meant to be read, still less to be understood.'⁸ The written document, however, may be seen by purchasing agents, sales personnel and engineers as a formality created only to please the whims of the lawyers. It is also possible that parties will

⁵ See Professor Linzer's discussion of *Shore v Motorola*, in P. Linzer, 'Rough Justice: A Theory of Restitution and Reliance, Contracts and Torts' (2001) *Wisconsin Law Review* 695, 764-772. The price of the position I take in this article is that I have to accept that sometimes judges will use their discretion to reach results that I think are outrageous. *Shore v Motorola* was for me an unhappy example.

⁶ By the 'real deal' I mean both those actual expectations that exist in and out of a written contract and the generalised expectation that a trading partner will behave reasonably in solving problems as they arise. My experience talking with business people suggests that reading written contracts clauses to one another seldom would be seen as a reasonable way to solve problems. There may be situations where applying the letter of a written document would be a reasonable way to cope with a contract problem, but I suspect that these situations are a very limited group of all contract problems. Also, there are situations where parties do not expect the other to act reasonably for the mutual benefit of the relationship. Again, I would expect this to be a very limited group of cases because some trust is needed before most people will make contracts.

⁷ T. M. Palay, 'A Contract Does Not a Contract Make' (1985) *Wisconsin Law Review* 561, 562.

⁸ The phrase is Lord Justice Devlin's. See *McCutcheon v David MacBrayne, Inc* [1964] 1 WLR 125.

write or accept a flat, unqualified contract clause but assume that there are exceptions or qualifications that are not worth the effort to spell out in advance. In short, there are many reasons that the paper deal will fail to capture the real deal. As a matter of fact, there is a 'text between the lines.'

The performance of contractual obligations often will be prolonged in time and require the active cooperation of both parties. Situations may change during the time that one or both parties are attempting to perform or it may become clear that the written language is an inadequate guide to performance. While parties can modify their written contract, often they do not engage in an explicit renegotiation. Rather, they make adjustments as they attempt to cope with the demands of the original agreement and the new situation. Sometimes we can say that when the parties signed a written agreement, they intended their contract to be adjusted in light of continually changing circumstances. In some kinds of contracts, cancellation for convenience or broad impossibility/frustration clauses are common. Sometimes the written contract provides that if event X happens, 'the contract shall be equitably adjusted.' Often, however, we can suspect that those who signed the written document never thought about the possibility of changes beyond a general tacit assumption that both sides would proceed in good faith.

American law: rule and counter-rule, core and periphery

The law: something less than certainty and perfect predictability

How does or should contract law respond to any gap between the paper deal and the real deal? Let me briefly sketch some of the approaches taken by American courts or advocated by American writers.⁹ I offer American law and writing only as an example which I know. I do not presume that they should be a model for the rest of the world.

People can respond to a problem by denying that it exists. We could point to many judicial opinions that talk about the plain meaning of a written contract without ever considering how they know that this is what the parties meant. This is the strongest version of the parol evidence rule.¹⁰ There is an old American expression that tells us that 'if it looks like a duck, waddles like a duck and quacks like a duck, it is a duck!' Sometimes an objective theory of contracts gives us, essentially, the duck test. If I signed a writing, you are entitled to rely on my agreement to the plain meaning of the words written, typed or printed. Sometimes this position is reinforced by a tort-like duty to read and understand which can transform contract law's claim to rest on choice into pure magic. Also, there is an assumption, often unstated, that all the parties' rights and duties must be traced back to the specific provisions of their written agreement. Courts say that they will not make a contract for the parties. However, when judges want to impose contractual liability, implied conditions and strange readings of contract language rationalize the enforcement of what judges think parties ought to have done.

⁹ See J. M. Feinman, 'The Significance of Contract Theory' (1990) 58 *Cincinnati Law Review* 1283.

¹⁰ See J. D. Calamari and J. M. Perillo, 'A Plea for a Uniform Parol Evidence Rule and Principles of Contract Interpretation' (1967) 42 *Indiana Law Journal* 333; W. C. Whitford, 'The Role of the Jury (and the Fact/Law Distinction) in the Interpretation of Written Contracts' (2001) *Wisconsin Law Review* 931.

Sometimes, of course, implied conditions and strange readings rationalize a judge's refusal to enforce the bargain that the parties made.

Lawrence Friedman pointed out that American contract law in the late Nineteenth and early Twentieth Centuries was grounded in abstraction; it offered rules assumed to be applicable whether the parties were rich or poor and without regard to the subject matter of the transaction. The rules purported to be unchanging over time. However, when faced with the demands of a developing economy, American courts used tools such as waiver and estoppel and construction of language to bend specific rules into conforming with standards of higher generality.¹¹ Often careful study would reveal that contract law featured a rule opposed by a counter rule with no principled way of knowing when one or the other would apply. American law, for example, tells us that it is not duress to threaten to do what you have a legal right to do.¹² Yet a wrongful although not illegal threat can be duress.¹³ These two statements of the law do not live together happily.

The legal realists had a fine time dropping bombs on ideas about plain meaning and abstraction. The more you know about language, the less comfortable you are with ideas that any collection of words has but one complete and clear meaning apart from context. Recognising this, Professor Corbin would reduce doctrines such as the parol evidence rule to a possibility that seldom would apply. Parol evidence is to be excluded when the parties intended their writing to be the final expression of their agreement. Corbin, however, argued that such an intention about finality was a fact to be proved by any relevant evidence that was credible. He thought that judges should not blind themselves to everything but the text of a writing. Justice Roger Traynor of the Supreme Court of California wrote this form of realism into the law of his state, at least for a time.¹⁴ A California judge was not to look for the plain meaning. He or she could look to evidence of intention other than the text of a written contract even when the words did not seem to be ambiguous.

To a great extent, legal realism was written into American law when Professor Karl Llewellyn became the Reporter for Article 2 of our Uniform Commercial Code. Article 2 became the law in almost all American states by 1965. In Llewellyn's Code, much turns on the concept of 'agreement.' Section 1-201(3) defines this concept as 'the bargain of the parties in fact as found in their language or by implication from other circumstances ...' The phrase 'bargain of the parties in fact' would seem to call for enforcing the real deal rather than holding people to any asserted plain meaning of the documents which they signed or accepted. The Code also attempts to cut back the idea that contracts must be defined with certainty.¹⁵ Llewellyn celebrated what he called the grand style of common law

11 L. M. Friedman, *Contract Law in America: a Social and Economic Case Study* (Madison, WI: Univ Wisconsin Press, 1965).

12 See eg, *Wurtz v Fleischman* 97 Wis.2d 100, 293 N.W.2d 155 (1980).

13 Restatement (2d) Contracts §176(2)(c) tells us that a threat is 'improper if the resulting exchange is not on fair terms, and ... what is threatened is otherwise a use of a power for illegitimate ends.' See C. Dalton, 'An Essay in the Deconstruction of Contract Doctrine' (1985) 94 *Yale Law Journal* 997, 1032-36, for a criticism of this approach. Dalton sees the Restatement as evading the real but difficult questions about what are 'illegitimate ends' for the use of power.

14 See eg, *Masterson v Sine* 68 Cal.2d 222, 436 P.2d 561 (1968); *Pacific Gas & Elect Co v GW Thomas Drayage & Rigging Co* 69 Cal.2d 33, 442 P.2d 641 (1968).

15 Section 2-204(1) says '[a] contract for sale of goods may be made in any manner sufficient to show agreement, including conduct by both parties which recognises the existence of a contract.' We can have an enforceable contract although the price is uncertain, quantity is defined only as 'requirements,' and nothing is said about the date for performance.

judging.¹⁶ Judges working in the grand style did not apply rules mindlessly. Rather, drawing on their situation sense, rules served only as guides to judgment.¹⁷

However, the Code is not pure Llewellyn but a compromise between the legal realism of the academics who produced the first drafts and the traditional views of the commercial lawyers who forced revisions.¹⁸ Llewellyn was not free to innovate at will. He had to obtain the blessing of the American Law Institute and the National Conference of Commissions on Uniform State Law. Moreover, the Code had to be passed by state legislatures, most of which had many members who were lawyers trained in the conventional wisdom. Article 2 has, for example, a parol evidence rule and a Statute of Frauds. In the hands of a judge holding traditional views, there are ways to read the Code that can serve as a road back to the familiar territory of the common law of contracts. In making this move, it helps to ignore the definitional sections of the statute. As a result, Article 2 often preserves aspects of the classic common law approaches but seeks to change the common law enough to deal with modern conditions. It can be considered an example of 'neo-classical contract.'¹⁹ In short, many of the tools needed to seek the implicit dimensions of contract are in Article 2, but even judges who read statutes carefully do not have to use these tools.²⁰

Scholarly reaction: modern challenges to code methods

In the last decade or two, some American scholars have questioned the approach of Article 2 of the Uniform Commercial Code as a means of achieving its announced ends. It was, they say, sold as a uniform law, but it fails to produce

16 See K. N. Llewellyn, *The Common Law Tradition: Deciding Appeals* (Boston, MA: Little, Brown and Co., 1960) 64-72; W. Twining, *Karl Llewellyn and the Realist Movement* (Norman, OK: Univ Oklahoma Press, 1973) 210-245.

17 For example, Section 1-102(1), Official Comment 1, says: 'The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case maybe, in conformity with the purposes and policies involved.' Section 1-205, Official Comment 1, says: 'The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.'

18 See A. R. Kamp, 'Downtown Code: A History of the Uniform Commercial Code 1949-1954' (2001) 49 *Buffalo Law Review* 359 ('[T]he present Code is a product of two conflicting visions of what commercial law should be - one, a regulatory system based on self-regulation by the trade, judicial supervision according to commercial norms, and legislative dictate, as opposed to one based on an autonomous business world operating under a regime of unregulated contract.') *Ibid* 361. 'Llewellyn's views and his original program for the Code grew out of the matrix of the collectivist mentality of the 1930s ... Llewellyn was once part of an academic avant guard, a supporter of FDR [President Roosevelt] in his court-packing plan, a folk dancer, a student of Boas' anthropology, part of a 1930s radical, collectivist milieu.' *Ibid* 392.) See also, A. R. Kamp, 'Between-The-Wars Social Thought: Karl Llewellyn, Legal Realism, and the Uniform Commercial Code in Context' (1995) 59 *Albany Law Review* 325; A. R. Kamp, 'Uptown Act: A History of the Uniform Commercial Code: 1940-1949' (1998) 51 *SMU Law Review* 275; A. R. Kamp, 'Increasing Complexity in Commercial Law: The Failure of the Uniform Commercial Code' (1991) 10 *Corporate Counsel Review* 59.

19 In the right hands, however, Article 2 offers an opportunity for an application of a relational theory of contract to specific problems. See I. R. Macneil, 'Restatement (2d) of Contracts and Presentation' (1974) 60 *Virginia Law Review* 589; Richard E. Speidel, 'Article 2 and Relational Sales Contracts' (1993) 26 *Loyola of Los Angeles Law Review* 789.

20 See A. H. Kastely, 'Stock Equipment for the Bargain in Fact: Trade Usage, "Express Terms," and Consistency Under Section 1-205 of the Uniform Commercial Code' (1986) 64 *North Carolina Law Review* 777.

uniform results. In its contextual approach, every case is different. Llewellyn had defended his open textured qualitative provisions in Article 2 by saying that the common law method would, over time, provide enough certainty. Courts would give meaning to concepts such as 'unconscionability' or 'commercial reasonableness' by deciding a series of cases involving specific facts. Patterns would emerge and judges and scholars would be able to discern working rules. Moreover, Llewellyn thought that judges could be informed of the usages of trade in order to give content to Article 2's frequent reference to reasonable commercial behaviour.

Many have challenged Llewellyn's justifications for the way that Article 2 of the UCC is drafted. Here I will look at two writers whose work I admire, Dean Robert Scott and Professor Lisa Bernstein. Both do empirical work, and both are sensitive to making theories about contract accord with business practice. Dean Scott has questioned whether more than 30 years experience with the Code has done much to make its qualitative standards clear to lawyers. He has studied American courts dealing with these general norms.²¹ Scott accepts that most contractual transactions are relational. However, he argues 'the state's primary substantive role in uniformly enforcing commercial contracts is to regulate incomplete contracts efficiently.'²² This involves two often inconsistent tasks: Courts must 'correctly (or uniformly) interpret... the meaning of the contract terms chosen by the parties to allocate contract risk.' They also must create 'broadly suitable default rules and/or... [label] widely used contract terms and clauses with standard meanings.' He argues that uniformity requires not just that the same substantive standards be adopted by all American states. For all of the advantages of uniformity, courts in all states must apply those standards in predictable ways. He finds that Article 2 of the Uniform Commercial code fails to give reliable and predictable interpretations of contractual text. Llewellyn's theory about courts developing consistent readings of and reactions to contract terms incrementally over time has not proved accurate. Dean Scott asserts:

While the Code was explicitly designed to incorporate evolving norms into an ever-growing set of legally defined default rules, incorporation as such has simply not occurred. To be sure, courts have interpreted contracts in which context evidence has been evaluated together with the written terms of the contract.... But while such judicial decisions affirm the institutional bias toward contextualizing contract, the fact-specific nature of the contract dispute leaves, in virtually every case, little opportunity for subsequent incorporation as tailored defaults.... A systematic examination of the litigated cases interpreting the 'reasonableness' standards of Article 2 reveals that courts have consistently interpreted these statutory instructions not as inductive directions to incorporate commercial norms and prototypes but rather as invitations to make deductive speculations according to "Code policy" or other noncontextual criteria.²³

21 R. E. Scott, 'Rethinking the Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies' in J. S. Kraus and S. D. Walt (eds) *The Jurisprudential Foundations of Corporate and Commercial Law* (Cambridge: Cambridge University Press, 2000) 149, 166 n. 68; R. E. Scott, 'The Case for Formalism in Relational Contract' (2000) 94 *Northwestern University Law Review* 847. See also, R. E. Scott, 'Conflict and Cooperation in Long-Term Contracts' (1987) 75 *California Law Review* 2005; R. E. Scott, 'A Relational Theory of Default Rules for Commercial Contracts' (1990) 19 *Journal of Legal Studies* 597. Compare O. Ben-Shahar, 'The Tentative Case Against Flexibility in Commercial Law' (1999) 66 *University of Chicago Law Review* 781. For an earlier, and very well done, presentation of the arguments against flexibility in the Code, see A. I. Rosett, 'Contract Performance: Promises, Conditions and the Obligation to Communicate' (1975) 22 *UCLA Law Review* 1083.

22 R. E. Scott, 'The Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies' *ibid* 149, 150.

23 Scott, 'Rethinking the Uniformity Norm in Commercial Law', *ibid* 164.

Scott's conclusions are not surprising. Insofar as courts try to apply general relational norms to particular transactions, they are seeking goals other than uniformity of application. Scott's solution to the uniformity problem is a return to formalism, a plain-meaning approach to interpretation and a strict parol evidence rule. Often, for reasons that I have indicated, this will defend written text at the cost of defeating actual expectations and the implicit dimensions of contract. To a great extent, any differences between my judgments and those of Professor Scott turn on how much we value predictable results when there are disputes. He seems ready to trade having courts seek the assumptions of the parties for something approaching certainty. He says:

[T]he efficient regulation of contract does not require that every relational norm be judicialized or that the legal mechanism operates efficiently viewed on its own terms, but rather that it operates efficiently in concern with social norms of trust, reciprocity, and conditional cooperation that also regulate relational contracts. Under the formalist approach, these norms would not be legally enforceable contract terms....but they nevertheless would be enforced by social sanctions that would effectively constrain the parties' incentives to exploit changed circumstances strategically.²⁴

I, on the other hand, am content with a contract law where lawyers can make probabilistic judgments about likely outcomes if, at the same time, we can enforce duties of cooperation and good faith. I would be very uncomfortable with a contract law that attempted to apply a plain meaning rule and a strict parol evidence rule to every situation.²⁵ In a great many cases, this would ignore actual expectations and allow the lawyers for the side that got to do the drafting to create a license for its sales people to lie and mislead. I would be more comfortable with Dean Scott's approach if it were limited to cases where bargainers were represented by lawyers and the language of the writing was subject to negotiation.²⁶

24 R. E. Scott, 'The Case for Formalism in Relational Contract' (2000) 94 *Northwestern University Law Review* 847, 861. See, also, R. E. Scott, 'Comment' (2002) 52 *Hastings Law Journal* 700: '[T]here are powerful normative forces in relational contracts and ... they regulate a great deal of the relationship ... and ... therefore legal default rules serve a minor but very important purpose as kind of a nuclear umbrella. ... [T]here's a difference between Contract as an institution, which is synthetic and relational, and Contract Law which is simple, formal, classical ... We have a set of rules for umbrella legal enforcement, and then a set of informal social norms that are better if not judicialised.'

25 Parties in specific industries or trades can minimize the risk of having agreements interpreted in light of an expanded consideration of context if this is what they want. They can withdraw from the public courts by providing for arbitration. Insofar as they can influence or control who will do the arbitrating, they can opt for an expert who will bring an expanded view of context because of his experience. Or they can opt for a person who approaches written contracts very literally. Professor Daintith suggests that the presence of arbitration clauses in contracts does not necessarily suggest that parties expect conflict. '[E]xperience shows that parties do not in fact resort to arbitration as a mode of settlement [in the iron ore market]. Incorporation of an arbitration clause, I would suggest, shows only that the parties wish to avoid the possibility that a dispute will come before the ordinary courts.' T. Daintith and G. Teubner (eds), *The Design and the Performance of Long-Term Contracts, in Contract and Organisation: Legal Analysis in the Light of Economic and Social Theory* (Berlin: Walter de Gruyter, 1986) 164. For a criticism of the move to arbitration that is so common today, see C. A. Carr and M. R. Jencks, 'The Privatization of Business and Commercial Dispute Resolution' (2000) 88 *Kentucky Law Journal* 183.

26 This was the approach of the United States Court of Appeals for the Seventh Circuit in the early 1980s. See *Binks Manufacturing Co v National Presto Industries, Inc* 709 F.2d 1109 (7th Cir. 1983); *Air Line Stewards and Stewardesses Assoc v Trans World Airlines* 713 F.2d 319 (7th Cir. 1983). Given that court's tendency to ignore its own precedents, the status of these decisions is uncertain. See Linzer, n 5 above.

Scott acknowledges that "[o]ne who argues for a return to acontextual modes of interpretation has to concede, and I do, that there are real costs to a return to the common law approach."²⁷ This is well said. Yet there is another point: I am still enough of a legal realist to doubt whether courts would or could abandon a contextual approach to giving meaning to language and behavior. Just as some writers are skeptical about whether courts can apply a realist approach, we can be equally skeptical about whether courts can be truly formal and close their eyes to everything but the words on a piece of paper. Even the classic formalist parol evidence rule allowed contextual evidence if terms were 'ambiguous.' In the hands of many judges, this opens the door to a case-by-case policy approach. Would the advocates of near-certainty abandon this exception? Could they abandon it if they wanted to do so without reducing contract interpretation to an empty ritual? Or put in Chief Judge Richard Posner's words:

[It is] an embarrassment for a theory of judicial legitimacy that denies that judges have any right to exercise discretion. A choice among semantically plausible interpretations of a text, in circumstances remote from those contemplated by its drafters, requires the exercise of discretion and the weighing of consequences. Reading is not a form of deduction; understanding requires a consideration of consequences... The broader principle ... is that if one possible interpretation of an ambiguous statement would entail absurd or terrible results, that is a good reason to adopt an alternative interpretation.²⁸

Furthermore, if we really wanted certainty and predictability, we would have to wipe out such doctrines as waiver and estoppel. We would have to do without doctrines such as substantial performance or requirements that breaches be material in order to trigger rights to call off contracts. We would have to make very clear any rules that required aggrieved parties to give notice that they considered the contract to be breached. Furthermore, I cannot imagine anything such as the doctrines of mistake, impossibility and frustration being expressed in certain terms that did not require judgment. Perhaps others can imagine judges closing their eyes to context, but my imagination will not carry me that far. Even the most formalist judge will read the paper deal knowing that it describes a sale of machinery, a bank loan, a franchise under which one party gains rights to sell new cars and so on. Such a judge probably will have his or her own experiences that will color the way that he or she understands the language used as applied to the situation before the court. Moreover, such a judge, or his or her law clerk, will have read some or all of the record on appeal, and usually it is filled with context. This is not to say that a formalist judge cannot write an acontextual opinion. However, decision and rationalization are different matters.

Moreover, the possibility of minting useful default rules that would eliminate almost all uncertainty strikes me as questionable. I can imagine some relatively certain default rules.²⁹ I suspect, however, that in creating default rules for many situations courts would feel a need to use some general terms calling on judgment

27 R. E. Scott, 'Is Article Two the Best We Can Do?' (2001) 52 *Hastings Law Journal* 677, 687.

28 R. A. Posner, 'What Am I? A Potted Plant?' *The New Republic*, 18 Sept 1987, 23. Posner continues, saying: 'There has never been a time when the courts of the United States, state or federal, behaved consistently in accordance with ... [legal formalism]. Nor could they, for reasons rooted in the nature of law and legal institutions, in the limitations of human knowledge, and in the character of the political system.'

29 For example, when a contract made in Madison, Wisconsin speaks of the price as a specified number of dollars, American law would tell the judge to read this as United States dollars and not Australian dollars. Yet the case gets harder when the parties deal over the Internet and one is in Madison and the other is in Sydney.

in application. For example, suppose the parties failed to provide for the time of performance. I accept that it might be very useful to know for sure whether the seller would have to perform a day, a week or a month after the contract was signed. Nonetheless, can we imagine being satisfied with a rule that provided that all contracts made without a fixed date for delivery had to be performed within a week after they were signed? The rule would *look* certain, but there is not much more that could be said for it. Courts could gain certainty by refusing to enforce any contract that did not specify a date for performance. Yet this would make many bargains unenforceable even when it was clear that a seller's failure to deliver had continued far beyond any reasonable time for performance. I would find this too much to pay for whatever benefits near certainty would bring.

Furthermore, I can imagine many situations where there would be good arguments for both sides as we tried to apply these brave new clear default rules to the particular facts of the case. It is not news that even certain rules do not necessarily yield certain results as applied, particularly in an adversary system that rewards lawyers for putting a self-serving spin on situations. And jurors and judges can pretend that facts exist, or do not exist, as a means to defeat a result seemingly dictated by the clearest rule of substantive law that the most skilled drafter can fashion. This may not be playing the game, but those of us who read briefs and excerpts from the record as well as appellate opinions have so often been startled when appellate judges get to where they want to go by fudging the facts that we really should no longer be surprised.

Scott, as well as others such as Bernstein, argue that business people may honor relational norms and sanctions while a relationship is underway, but when it breaks up, they may want 'end-game norms' to apply.³⁰ These end-game norms often appear in written formal contracts, but parties may pay little attention to them as they perform. During the life of a relationship, for example, a buyer may accept delayed deliveries. Once the parties reach the end-game when the relationship is not going to continue, the buyer may wish to insist on the written contract's fixed delivery dates to justify ending or limiting its obligations to the seller. The point is similar to one that Professor Fuller made in his 1947 casebook:

The practice actually followed in the settlement of claims by companies which employ a standard form for transacting business is often much more liberal than might be inferred from the terms of the contract they ask their customers to sign. ... The companies ... seek a contractual margin of safety within which they can exercise their own discretion free from the threat of litigation³¹

Once a relationship comes to the end-game, reading a written contract literally sometimes may seem appropriate. For example, this often will be the case when the contract deals with borrowing money. I think that most people understand that money lenders can be expected to turn to the text of financing instruments when it comes time to call in a loan. Sometimes, however, turning to a writing at

30 See R. Scott, 'A Relational Theory of Default Rules for Commercial Contracts' (1990) 19 *Journal of Legal Studies* 597, 615: 'The parties, in essence, have learned to behave under two sets of rules: a strict set of rules for legal enforcement and a more flexible set of rules for social enforcement.'

31 L. L. Fuller, *Basic Contract Law* (St. Paul, MN: West Publishing Co., 1947) 213. He continues: 'To obtain a proper perspective of the whole question, one must also consider whether trial in court, especially before a jury, is an efficient and just means of settling disputes involving small sums.'

end-game would only disappoint expectations created during the process of attempting to maintain a relationship. Courts had good reasons for fashioning the doctrines of waiver, interpreting contracts by the course of performance and rules that require an aggrieved party to give the other notice that s/he thinks that there has been a breach of contract. We cannot assume that parties always intend one set of rules for performance and another for resolving disputes before courts.³² This would seem particularly true when a written document was signed as a formality signifying commitment but not read nor understood by those who negotiated it.

Professor Lisa Bernstein has engaged in a grand empirical study of commercial custom.³³ Llewellyn, in drafting Article 2 of the UCC, again and again turned to business practices to give content to the qualitative standards found in his rules. After interviewing many business people, Bernstein does not find much trade usage that would be useful to courts in deciding particular cases. Customs are vague, and they often differ from place to place. Published codes of trade practice often are far more political than empirical, reflecting power struggles in trade associations rather than the expectations of typical members of the trade.

Bernstein's judgment about usage often will be right. Yet there are some customs and practices that can give meaning to the words in an agreement. Seldom, however, can judges just pick up the quaint native customs of business people and plug them into contracts without interpretation. Customs often are vague and qualified by imprecise exceptions. At best, such a custom may influence a court's judgment but not decide the case. Judges and jurors can be informed about community standards by expert witnesses. Of course, a critic may object that experts can be bought to testify to just about anything. Of course, we can hope that legal decision-makers can ward off biased claims in light of what makes sense in a commercial setting, at least in most cases.

Llewellyn had a different argument for the qualitative approach of Article 2 of the UCC. Judges might not be able to rely on trade usage because none existed or none could be proved. There also might be no established default rule because courts would not have worked one out incrementally through a series of cases. Nonetheless, Llewellyn argued that judges could rely on their 'situation sense'³⁴ - informed intuition - and the policies expressed and implied in the Code, and, perhaps, in the legal culture of their time.³⁵ He thought that typically judges would reach a defensible result, although they might not explain it well. In America there

32 See S. Macaulay, 'Relational Contracts Floating on a Sea of Custom? Thoughts About the Ideas of Ian Macneil and Lisa Bernstein' (2000) 94 *Northwestern University Law Review* 775, 794-796.

33 See L. Bernstein, 'The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study' (1999) 66 *University of Chicago Law Review* 710; L. Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' (1996) 144 *University of Pennsylvania Law Review* 1765. For my largely favourable comments on Bernstein's work, see S. Macaulay, 'Relational Contracts Floating on a Sea of Custom? Thoughts About the Ideas of Ian Macneil and Lisa Bernstein' *ibid.* Compare R. Epstein, 'Confusion About Custom: Disentangling Informal Customs from Standard Contractual Provisions' (1999) 66 *University of Chicago Law Review* 821.

34 See Twining above, n 16 above, 225 ('A judge in a commercial case who can see the facts in the way businessmen would see them, as well as from the lawyer's point of view and from the point of view of the "mores" of the community as a whole, has grasped "wisdom."').

35 See Llewellyn above, n 16 above, 4. Leon Trakman develops this idea and argues that judicial discretion will not be capricious because of the inherent controls in the common law system apart from the rules of contract law. See Trakman, 'The Effect of Illegality in the Law of Contract: Suggestions for Reform' (1977) 55 *Canadian Bar Review/La Revue des Barreaux Canadiens* 627, 652-54.

are many roads to a judgeship, but some judges will have some background in business as a result of their practice before they took the bench. In many cases, the practice of law itself involves participating in a small business, and this experience could affect attitudes and assumptions. Lawyers argue legal rules, but they know that appeals to "common sense" can reinforce their technical claim.

Would an informed intuitive policy approach produce complete uncertainty? Llewellyn argues that it would produce 'reckonability' rather than uncertainty. Farber and Matheson note:

Courts often resort to conclusory language in find that a manifestation rises to the level of a promise... [R]elationships and surrounding circumstances do not speak for themselves. They must be interpreted by judges on the basis of expectations likely to arise between similarly situated parties. The conclusory tone follows because we are being told what we ought to already understand as members of the community.³⁶

Lawyers might not know for sure how a particular case would be resolved, but, as members of the community of commercial lawyers, they would have a good idea of the probabilities. They would be aware that some cases were close ones with good arguments for both sides. These they could consider settling, and these situations might provoke changes in drafting, negotiation or both in the future. Those who advise American corporations are not helpless in the face of demands for such things as 'commercial reasonableness' and avoiding 'unconscionability.' They can help clients change behavior so that there is little question about running afoul of such qualitative standards. They can advise clients about the risks, and clients can decide to take the chance that a court might disapprove of certain practices. Lawyers might even get their clients to tone down advertising that creates expectations that they cannot satisfy.

If the burden on business flowing from a particular application of a rule were great enough, business interests could seek legislation to clarify or reverse the offending reading of the law. Their lawyers could redraft standard language to make it more likely that they would win the next time the problem comes before the courts. In some situations, they could move the game from the courts to arbitration and select their own judges and rules.

Clearly, any intuitive approach to the qualitative standards found in Article 2 will not serve the purposes that Dean Scott specifies in his writings. It will not give us uniformity in the application of the law nor produce clear default rules. Nonetheless, Llewellyn's whole approach should prompt us to ask how much uniformity we need and what price are we willing to pay for it? Dean Scott's study suggests that courts have not defined general standards or worked out specific rules very often. They just announce conclusions without offering much by way of explanation. Yet we can ask whether American contracts decisions leave an experienced business lawyer at sea with no land in sight. It would be hard to answer this question by an empirical study because of the vagueness of the question. Nonetheless, the lawyers with whom I talk continue to draft contracts and to interpret them for clients. Many of them are confident that they can predict what courts are likely to do with a contract problem. Again, there may be types of contracts or particular situations where more certainty would be highly valuable and where other-than-legal relational norms and sanctions are all that we need. However, giving content to this idea requires that we look at the realities of

36 Farber and Matheson, 'Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake"' (1985) 52 *University of Chicago Law Review* 903, 915 n 45.

various types of business transactions in detail before we make judgments about the need for greater certainty and clarity, the power of relational norms and sanctions and the costs of a flexible judicial approach. The problem is to avoid over-generalisation.

This is but a quick sketch of debates in the American contract field. Yet it should make clear that not everyone accepts that courts should pursue the implicit dimensions of contract. Moreover, American contract law has not been certain and perfectly predictable.

'The Rule of Law', Trust and Economic Development

Concern for the 'rule of law' could inhibit courts from searching for the implicit dimensions of contract.³⁷ Hendley observes that the phrase 'has become a trendy political slogan around the world.'³⁸ However, she notes that the content of the phrase and the means to achieve this goal are most uncertain. Ohnesorge has reviewed the various publications of international organisations, political leaders and scholars who deal with the concept.³⁹ He finds that those who are not lawyers tend to assume that the rule of law is a condition of a society which is governed by a complete and functioning legal system. A society either is characterised by the rule of law or it is not. These writers assume that legal rules are 'not subject to significant indeterminacy, and that these are sufficient to provide single correct solutions without resorting to principles, policies or purposes.'⁴⁰ They also assume that the rule of law is useful because the more the future can be made predictable, the easier it is to plan and take risks in a capitalist society. Under this view of the rule of law, the outcome of contract disputes should be predictable. Contract law would deter breaches and provide compensation when a party failed to perform. However, judges often will differ about the implications of words and behavior in context. This means that seeking the implicit dimensions to a contract would insert uncertainty into the system because the courts would have to exercise judgment about what was implied but not expressed. This is to be avoided.

Ohnesorge notes that legal scholars tend to see the rule of law only as an aspiration. A society honors the rule of law when a high number of its characteristics are met a high percentage of the time. These scholars have read many cases where the rules and their application to the facts were debatable. They are skeptical about whether single correct solutions exist for the kinds of cases that are filtered into appellate courts. Legal realism and experience have taught lawyers that the outcome of particular cases can never be perfectly certain. Nonetheless, as

37 For excellent discussions of the idea of the rule of law, see W. C. Whitford, 'The Rule of Law' 2000 *Wisconsin Law Review* 723; F. Lovett, 'A Positivist Account of the Rule of Law' (2002) 27 *Law & Social Inquiry* 41; M. Krygier, 'The Rule of Law' in N. J. Smelser and P. B. Bates (eds), *International Encyclopedia of the Social & Behavioral Sciences* (Amsterdam: Elsevier, 2001) 13403. Stephen Lubben examines claims that an approach to contract interpretation resting on qualitative standards is the same as the German free law movement that the Nazi's found useful. Not surprisingly, he is very sceptical of such a position. See S. J. Lubben, 'Chief Justice Traynor's Contract Jurisprudence and the Free Law Dilemma: Nazism, the Judiciary, and California's Contract Law' (1998) 7 *Southern California Interdisciplinary Law Journal* 81. See also E. L. Rubin, 'Discretion and Its Discontents' (1997) 72 *Chicago Kent Law Review* 1299.

38 K. Hendley, 'The Rule of Law and Economic Development in a Global Era' in A. Sarat (ed) *The Blackwell Companion to Law and Society* (forthcoming).

39 J. Ohnesorge, *The Rule of Law, Economic Development, and the Developmental States of Northeast Asia* (C. Antons (ed), forthcoming 2002).

40 *Ibid* at n 9.

we have seen, some legal scholars seek to increase the predictability of what courts will do with contract disputes.

The formal classical model of contract law has an illustrious history. We find traces of this version of the rule of law in Shakespeare's *The Merchant of Venice*. As you recall, Antonio has breached a contract, and, under its terms, he owes Shylock a pound of flesh. Several characters look for a way out, but others argue that the economy of Venice depends on the certain and predictable enforcement of contracts. Even Antonio himself rejects a suggestion that the judge should not enforce the bargain. He says that if the course of the law is denied, it will 'impeach the justice of the state'. This will harm the 'trade and profit of the city'. Of course, Shakespeare finds a way out of the dilemma, but it involves at least claiming to enforce the letter of the contract in the most formal sense. Shylock could take his pound of flesh, but he could not take a drop of blood. Shakespeare's court refused to look at the implicit dimension of that contract.

We also find traces of the classic model of the role of contract in the writings of the great sociologist Max Weber. Weber argued that capitalism and increasing 'formal rationality' go together. David Trubek tells us that Weber thought only a formal system of law can be predictable enough to support economic activity.⁴¹ Law seeking substantive ends leads to particularistic decisions. Such decisions make it impossible for business people to know in advance the right answers to legal questions. Formal justice, Weber argues, enhances individual opportunities, promotes self-determination and helps assure individual freedom.⁴² Trubek notes that Weber also argues, perhaps paradoxically, that formal thought in law may actually defeat the intent of transacting parties, and benefit those with power and

41 D. M. Trubek, 'Reconstructing Max Weber's Sociology of Law' (1985) 37 *Stanford Law Review* 919. See, also, D. M. Trubek, 'Max Weber's Tragic Modernism and the Study of Law in Society' (1986) 20 *Law & Society Review* 573. See, also, D. Campbell, 'Truth Claims and Value-Freedom in the Treatment of Legitimacy: The Case of Weber' (1986) 13 *Journal of Law and Society* 207.

42 On the other hand, a group of scholars has told us that economic conditions throughout the world are better in nations that have legal systems based on the common law than in nations with legal systems based on European continental codes. Florencio Lopez-de-Silanes, Rafael La Porta, Andrei Shleifer and Robert Vishny reached this conclusion in a study conducted for the National Bureau of Economic Research. See R. Morin, 'Unconventional Wisdom: New Facts and Hot Stats from the Social Sciences' *The Washington Post* 1 November 1998. The current version of the paper is 'Courts: The Lex Mundi Project' revised March 2002. It is available at <<http://post.economics.harvard.edu/faculty/shleifer/papers.html>>. More recently, David Wessel, 'Capital: The Legal DNA of Good Economics, Wall Street Journal' 6 September 2001, relies on Andrei Shleifer's work to show: 'Rule-laden civil-law countries aren't well-adapted to cope with change: the case-law approach makes common-law countries inherently more flexible.' This turns Weber on his head. However, these scholars tell us that the legal culture of the continent allows legal and governmental officials to intervene in the market, applying vague rationalisations for regulation. This explanation is consistent with Weber's observations. Of course, we can look at such studies skeptically. Even if we accept the correlation between a legal culture based on common-law approaches and economic success, we can question just how much the common-law systems contribute to that success. American, British and Indian legal officials do intervene in the market, and substantive rationality can be found in each of their legal systems. It was not too long ago that we marveled at the German and Japanese economic miracles. Taiwan, South Korea and Japan all are civil law systems and economic successes. It is hard to believe that the more recent economic difficulties of these nations can be explained by the absence of the common-law tradition in these countries. There are many more likely suspects. Compare P. J. McConaughay, 'Rethinking the Role of Law and Contracts in East-West Commercial Relationships' (2001) 41 *Virginia Journal of International Law* 427, 432: 'The much-heralded worldwide "harmonization" of commercial law ... does not necessarily also herald its Westernisation; certain aspects of non-Western commercial traditions - for example, principles of accommodation and adjustment to future contingencies - are both consistent with core characteristics of the rule of law, and susceptible of reasonable articulation in commercial laws and contracts.'

wealth. In fact, Weber suggested that completely formal thought may be impossible.

Many scholars have been critical of the approaches to development championed by the World Bank and the International Monetary Fund, which have included the rule of law as a key component.⁴³ The larger criticisms focus on the presumption that private actors in markets unchecked by regulation produce the greatest good. As Silbey remarks, '[l]aw is relegated to ... [a] ... subordinate role as a background figure providing context but little determinative action ... [T]he market narrative is a parable about lowering expectations about what collectivities can or should do. It thus asks us to limit our conceptions of justice to a contentless efficiency.'⁴⁴

Conceding that many of the ideas captured by the phrase 'rule of law' are valuable, other critics question whether it is enough to enact particular laws or to adopt a formalist approach. Creating a rule of law with substance is not a mere technical matter. Legal institutions rest on a larger legal culture.⁴⁵ In Campbell's words: 'An effective contract law requires an ethically endorsed framework for cooperation between involved parties which cannot be reduced to technical predictability.'⁴⁶

Accepting that nations in transition to market economies need laws governing property, contract and bankruptcy, must courts abandon searching for the implicit dimensions of contract and operate in as formalist a way as possible? First, we could argue again that contract law plays but a minor role in a limited subset of situations.⁴⁷ As a result, courts are free to argue their decisions in terms of substantive rationality; any loss in predictability just will not matter much. Whatever theories say about the efficiency of clear rules, American contract law often is uncertain, featuring a rule neatly matched by a counterrule. Often there is, as Duncan Kennedy has pointed out, what seems to be a hard rule but it is encircled by a periphery of soft exceptions.⁴⁸ American legal procedure is costly and subject to procedural games such as discovery abuse and what seems to be endless delays. We have a relatively easy system of bankruptcy that can serve to wipe out or modify drastically contractual obligations.⁴⁹ Nonetheless, even with this kind of uncertain contract law in action, America has enjoyed great economic success. What is predictable is that contracts in the United States will be carried

43 See, eg J. E. Stiglitz, *Globalization and Its Discontents* (New York: W. W. Norton & Co., 2002) 139, 160–161, 208–209; H.-J. Chang, *J. Stiglitz and the World Bank: The Rebel Within* (London: Anthem Press, 2001) 96.

44 S. S. Silbey, "'Let Them Eat Cake:': Globalization, Postmodern Colonialism, and the Possibilities of Justice' (1997) 31 *Law & Society Review* 207. See also Udo Reifner's remark: 'While in former times capitalist nations used priests, soldiers and merchants to convince less developed peoples to adhere to their system, we can now rely on the convincing forces of the IMF, World Bank, BERD and other financial institutions where nations cue up to be accepted as members.' U. Reifner, 'The Vikings and the Romans - Contract Law and Social Economy' 6 (paper presented at the Conference on Perspectives of Critical Contract Law, Tuusula, Finland, 7–10 May 1992).

45 See Hendley, n 38 above.

46 D. Campbell, 'What is Meant by "the Rule of Law" in Asian Company Law Reform?' in R. Tomasic (ed) *Company Law in East Asia* (Aldershot: Dartmouth Publishing Co. Ltd and Ashgate Publishing Ltd., 1999) 11.

47 See C. J. Choi, 'Contract Enforcement Across Cultures' (1994) 15 *Organizational Studies* 673; P. H. Solomon, Jr, 'The Limits of Legal Order in Post-Soviet Russia' (1995) 11 *Post-Soviet Affairs* 89.

48 See D. Kennedy, 'Form and Substance in Private Law Adjudication' (1976) 89 *Harvard Law Review* 1685, 1700–1701, 1737.

49 See, eg, L. M. LoPucki & W. C. Whitford, 'Venue Choice and Forum Shopping in the Bankruptcy Reorganization of Large, Publicly Held Companies' 1991 *Wisconsin Law Review* 11. Compare R. Hillman, 'Contract Excuse and Bankruptcy Discharge' (1990) 43 *Stanford Law Review* 99.

out in an acceptable fashion. When Americans make a contract, it is not certain that it be performed to the letter of its text or performed at all. Yet, it is a good bet that the parties will perform acceptably.

In my 1963 study of business practices related to contract, I note that 'business units are organised to perform commitments ...'⁵⁰ Most simply, someone in the seller's organisation must have a reason to stop goods that have been ordered from being delivered to the buyer. Someone in the buyer's organisation must have a reason to stop the standard procedure for paying bills. In an absence of a reason to the contrary, commitments are honored as a matter of course. Documents are needed to establish that there is a commitment. Sales people must communicate with financial people so that they will approve credit, to engineering people so that they will design and make the goods, and to shipping people so that they will package and deliver them. Of course, there can be mistakes, but most of the time mistakes are discovered and corrected. Contract law may play some subtle and indirect role in all of this. Business people do know that there are such things as actions for breach of contract. They also know that their reputation with their trading partner is valuable, and they do not knowingly do things that would damage it without a good reason. Most of the time, I would guess, avoiding breach of contract litigation is not something that business people spend much time thinking about. Insofar as this is true, the style of contract analysis used by judges will not matter much to people who are not law professors.⁵¹

Some scholars have argued that contract law plays a real and essential role in market economies. The case for formal approaches to maximise predictability importantly turns on one's position about such an economic role. Douglass North, for example, argues that relational contract sanctions work in simple transactions but complex contracts require formal drafting and the possibility of legal enforcement.⁵² Farber stresses the potential costs of relying on informal relational sanctions. He contends:

[I]nformal incentives [to gain acceptable contract performance] are costly; to the extent that inadequate legal incentives cause excessive use of informal incentives, economic efficiency suffers... Customers will tend to deal with sellers with whom they have dealt before and will tend not to engage in a widespread search for sellers. As a result, their willingness to shop for better prices can decrease. Furthermore, entry by new sellers becomes more difficult, because a reputation for reliability cannot be immediately established. Although these effects on behavior are difficult to quantify, they nevertheless represent real costs, because they impede the market's movement toward equilibrium.⁵³

Johnson, McMillan and Woodruff surveyed about 1,500 privately owned manufacturing firms in Poland, Slovakia, Romania, Russia and Ukraine.⁵⁴ They found that 'while informal relationships are the main basis for our firms'

50 S. Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55, 63.

51 To repeat, in some areas of business people do write contracts while carefully considering contract law. My point is simple, obvious but often overlooked: we should not over generalise from what is appropriate in particular areas to all contracts.

52 D. C. North, *Institutions, Institutional Change and Economic Performance* (Cambridge: Cambridge University Press, 1990) 56–60.

53 D. A. Farber, 'Reassessing the Economic Efficiency of Compensatory Damages for Breach of Contract' (1980) 66 *Virginia Law Review* 1443, 1465–66.

54 S. Johnson, J. McMillan and C. Woodruff, 'Courts and Relational Contracts' (2002) 18 *Journal of Law, Economics & Organization* 221.

contracting, the formal institutions also foster contracting ... [W]orkable courts encourage firms to take on new partners. It is by making it easier for new firms to enter that having workable courts improves on relational contracting and boosts overall productivity.' Deakin, Lane and Wilkinson⁵⁵ argue that contract law plays an important role in fostering trust, but they expand the idea of contract law to include both the legal and the other-than-legal norms external to the contract that create a stable framework for the process of exchange and the presence of a sense of trust between the parties.

While there is substance in all of these arguments, each can be questioned. These qualifications and doubts suggest that contract law may play a role only in a limited subset of cases. North's suggestion that relational contract is confined to simple transactions runs counter to experience, particularly in Asia.⁵⁶ We can find many complex contracts made and performed in situations where the chance of an effective legal remedy for breach is low or nonexistent. Indeed, a long-term complex contract often defeats a court's abilities to provide meaningful remedies for breach.⁵⁷ Relying on long-term continuing relationships can involve costs, as Farber suggests. However, Professor Okun pointed out that there are also gains.⁵⁸ He distinguishes auction markets from what he calls 'consumer markets', but his use of the term 'consumer' differs from the way most contracts professors would use it. In an auction market supply and demand affect prices directly, and we often get the benefits of competition. However, in what he calls consumer markets, buyers do not invest what would be needed to find a dependable seller offering the lowest price. Products sold in these markets usually are not standardised. Relying on long-term relationships minimises the costs of shopping and trying out products. Often the seller's reliability is highly valuable to the buyer who will not be able to procure a substitute quickly enough to avoid large losses. Okun concludes that whether the costs outweigh the gains is unclear. Often contract law enforced through the courts could do little to offset the losses a breach might cause. Awarding the increased costs of getting substitute goods elsewhere will not

55 S. Deakin, C. Lane and F. Wilkinson, "'Trust' or Law? Toward an Integrated Theory of Contractual Relations between Firms" (1994) 21 *Journal of Law and Society* 329.

56 See eg, J. Kaufman Winn, 'Law and Relational Practices in Taiwan' (1994) 28 *Law & Society Review* 193; Frank K. Upham, 'Comment - Speculations on Legal Informality: On Winn's "Relational Practices and the Marginalization of Law"' (1994) 28 *Law & Society Review* 233; Ohnesorge, n 39 above.

57 See eg *Bethlehem Steel Corp v Litton Industries Inc*, 507 Pa 88, 488 A.2d 581 (1985). Litton made an elaborate complex contract with Bethlehem to supply an innovative self-unloading ore boat at a price subject to an escalator clause. Litton gave Bethlehem an option to buy five additional vessels within five years. The prices of the ore boats purchased under the option were to be subject to escalation based upon a 'mutually agreed' price index. When Bethlehem tried to exercise the options, the parties were unable to agree on an escalator clause. The trial judge found that there was no enforceable contract. He said that the lack of a price indicated that the parties did not intend the options to be legally enforceable, and, even if they had intended to make such contracts, the court could not fill the gap and write an escalator clause based on the parties' agreement. An intermediate appellate court affirmed, as did the Supreme Court of Pennsylvania. Eleven appellate judges considered the case. Six found that the record supported the trial court's decision that no contract had been formed for the additional ore boats; five dissented and would have reversed. The majority said that a court could not fashion an escalator clause for the transactions covered by the option. It seemed to require that the basis for such a clause be found in the parties' agreement or trade usage. The dissenters thought that the trial court should have fashioned a reasonable option clause not limited to what it could find in the express agreement and trade usage. It was not clear how the dissenters would have the trial court fashion a reasonable escalator clause. Apparently, it was to use its discretion and make its own judgments about what a reasonable clause would provide.

58 A. Okun, *Prices & Quantities: A Macroeconomic Analysis* (Washington, DC: Brookings Institution, 1981) 89, 134-178.

work because either there are no substitutes available or they cannot be made and shipped in time. There may be little, if any, evidence of whether there would have been profits had there been no breach or the dollar amount of those profits.

Finally, it is unclear whether some blend of contract law enforced through courts and informal sanctions for breach creates the trust needed for a market economy. Generally, I agree with Deakin, Lane and Wilkinson that many factors unite to support the trust necessary for people to make plans and take risks. Indeed, if business people think that there is an efficient and effective system of contract law, it would not matter if they were wrong as long as they do not discover the truth through bitter experience. However, I have some reservations about what business people think that the law could do for them if a supplier failed to perform a contract or a buyer failed to pay. A few years ago, I responded to Deakin and his colleagues, saying:

I suspect that contract law contributes to trust most of those who know the least about it. My guess is that it operates as a vague threat that should be avoided in all but a few situations. As I argued in 1977:

The contract litigation process may also maintain a vague sense of threat that keeps everyone reasonably reliable ... For this process to operate, it is not necessary that business managers understand contract norms and the realities of the litigation process. Perhaps all that is needed is a sense that breach may entail disagreeable legal problems.⁵⁹

If Deakin, Lane and Wilkinson would define contract to include all of the legal devices that support secured transactions - real estate mortgages, structures that support buying machine tools, jet aircraft, automobiles and other expensive items 'on time' and the like - their position would seem even stronger. Secured transactions are where I think effective law matters most. However, even with this expansion, we must remember that the institution of secured financing also rests on other-than-legal tools such as credit ratings and ways of communicating information, rumors and gossip about the financial health of individuals and corporations.⁶⁰ Even here creditors write off a percentage of their loans as uncollectible and sometimes find their security of only marginal value. To some extent, the credit system works because the cost of these bad debts can be included in the overall price for credit.

Daintith suggests that business people in the iron ore industry distinguish written agreements from letters and memoranda. However, what is important to them is the formality itself and not legal enforceability. In other words, a formal written contract can have symbolic power. He explains the attachment to contractual form as follows:

First, the LTC [long term contract] facilitates the dealings of buyer and seller with important third parties. It reassures lenders ... It offers tidy answers to governments anxious for a fair return on their natural resources.

59 S. Macaulay, 'Crime and Custom in Business Society' (1995) 22 *Journal of Law and Society* 248, citing S. Macaulay, 'Elegant Models, Empirical Pictures, and the Complexities of Contract' (1977) 11 *Law & Society Review* 508, 518-520. Compare I. Bohnet, B. S. Frey and S. Huck, 'More Order with Less Law: On Contract Enforcement, Trust and Crowding' (2001) 95 *American Political Science Review* 131; A. Bigsten *et al*, 'Contract Flexibility and Dispute Resolution in African Manufacturing' (2000) 36 *Journal of Development Studies* 1.

60 See R. J. Mann, 'Information Technology and Non-Legal Sanctions in Financing Transactions' (2000) 98 *Michigan Law Review* 2494.

Second, it provides a fairly comprehensive set of parameters for the parties' regular - or irregular - dealings and discussions. If problems arise, say on a matter like quality, the LTC offers a series of elements - price, quantity, shipping, etc - which, at least at the beginning of the negotiation are fixed points of reference ...

Third, and most important, the LTC creates a privileged trading relationship between the parties, which is of great importance in times of difficult markets, of glut or scarcity, in the sense that it reinforces, by rendering unambiguous, each party's claim to remain in business relations with the other. It thus gives better, but not absolute, security to the trading position of each party.⁶¹

All in all, I doubt that courts seeking the implicit dimensions of contract would exert much influence on most business persons' assumptions about whether contract law might influence the other party's decisions about performing the bargain. Most business people do not stay up nights reading appellate opinions about contract law. Most of them seldom face contract litigation. A trade publication might tell them something about a case involving an unusual newsworthy situation, but such a story would be read in light of the business person's own experiences. My guess is that only a business person burned by a judicial opinion that "makes no sense" in his or her own case would lose his or her faith that most contracts will be performed and that contract law might make some contribution at the margin.

The American economy has been successful over the past half century, but we have lived with an uncertain contract law. In America we have gone from classic formalism, with many counter rules such as waiver, to Llewellyn's Article 2 of the Uniform Commercial Code. Article 2, to a great extent, called for 'judging in the grand style' and celebrated Weber's substantive rationality. Conservative judges appointed by President Reagan and like-minded governors have moved us toward a kind of formal rationality.⁶² However, formalism always has proved to be unstable, at least in the United States. Our judges and scholars have never been comfortable with certain rules that produce results that are hard to stomach. Moreover, there are enough wild cards in our contract law that any judge who wants to evade a clear formally rational rule in a particular case can rationalize his or her decision with a nicely aged precedent.

Ronen Shamir⁶³ has examined Max Weber's arguments about formally rational and substantively rational styles of law in United States history. He sees a never-ending series of cycles:

[T]he interplay between ideally formal and ideally substantive law corresponds to the interplay between periods of stability and reform in the political arena...

61 T. Daintith, 'The Design and the Performance of Long-Term Contracts' in T. Daintith and G. Teubner (eds), *Contract and Organisation: Legal Analysis in the Light of Economic and Social Theory* (Berlin: Walter de Gruyter, 1986) 164, 187-188. Compare E. L. Rubin, 'The Nonjudicial Life of Contract: Beyond the Shadow of the Law' (1995) 90 *Northwestern University Law Review* 107 ('There is a vast world of commercial relations - of contractual relations - waiting outside the judiciary's narrow chambers ... [When Grant Gilmore told us that Contract is Dead, he meant] that we must venture forth into that world if we want to avoid the charnel house of intellectual irrelevance.')

62 Compare R. J. Moody, 'The New Conceptualism in Contract Law' (1995) 74 *Oregon Law Review* 1131, with R. A. Hillman, 'The "New Conservatism" in Contract Law and the Process of Legal Change' (1999) 40 *Boston College Law Review* 879.

63 R. Shamir, 'Formal and Substantive Rationality in American Law: A Weberian Perspective' (1993) 2 *Social & Legal Studies* 45.

Autonomous law is discarded when its internal tensions and inconsistencies can no longer be sustained. But in order to institutionalise and permanently root desired reforms, a reawakening of formal rationality, as a means of ensuring stability, security and predictability, is again called for. In the sphere of the economic market, this means that the same old capitalists may dominate again after such 'radical' changes as, say, the Wagner Labor Relations Act. In the legal sphere, this means that legalistic orientations and strict formal procedures regain their power, albeit under new conditions. It is by invoking Weber's analysis that we may grasp the cycle of *formal rationality - internal contradictions - substantive rationality - substantive rationality - routinization - formal rationality*. Social change and progress appear, when they do, in the form of a spiral ascent: important and radical changes are introduced through substantive rationality; once in place, formal rationality, albeit on a new 'progressive' level, reappears.⁶⁴

One reason for the instability and cyclic movement from formal to substantive rationality and then back again, is the way that we rationalise contract law. Despite almost a century of celebrating an objective theory and hundreds, if not thousands, of cases talking about a duty to read, contract still is supposed to rest on choice. Academic writers can brush aside the phrase "the meeting of the minds," but courts still mention it constantly because it does express an important rationalisation widely accepted in society for contractual liability. When larger organisations deal with smaller organisations or with consumers, they use contract documents that resemble the statutes of private governments. Often it would be irrational to attempt to read these documents. Usually people ignore them and rely on norms present in relational contracts.⁶⁵ These private governments raise the text of the printed form contract only when trouble arises and when means more appropriate to relationships have failed. Whatever the efficiency claims for treating the document as if it had been freely agreed to and a reflection of the party's contract, often the element of choice is just too attenuated for the comfort of a judge writing an opinion. Sometimes, we can suspect, second class choice is accompanied by a contract clause that, as applied to the particular case, just does not seem fair judged completely intuitively. Most of us will not worry about whether the expectations of a lawyer who tried to draft a license for sales people to lie will be defeated if a court seeks the real expectations of the one tricked.

Importantly, this is American legal history. As I have emphasised, despite, or because of, the imprecise and often conflicting nature of our contract law, the American economy has been successful. Those who would argue for a limited judicial role, formal and clear rules and technical predictability can claim only that things might have been even better had we had a very different kind of contract law. Whether a different kind of contract law would have been beneficial is a difficult empirical question. It involves assumptions about when and how the nature of contract doctrine will matter to those who deal in a market economy. However, clearly there is room for a contract law with strong elements of

64 *Ibid* 63-65.

65 Macneil observes: '[N]o one can honestly say that consumers *ought* to read long documents of this kind. The many courts which over the years have casually or not so casually said that ignore the fact that if consumers actually did such a foolish thing the modern economy would come to a screeching halt.' I. R. Macneil, 'Bureaucracy and Contracts of Adhesion' (1984) 22 *Osgoode Hall Law Journal* 5, 5-6. Macneil argues that you cannot legitimately holding people to such contracts by either choice or fault. Rather, the legitimacy must come from holding people to be bureaucrats in organisations performing consumer functions such as the Ford Motor Company. This way the justification is the same as holding us to many relationships which we enter not knowing the details of what we will be called on to do, such as military service, working for a law firm and marriage. Compare A. M. White and C. Lesser Mansfield, 'Literacy and Contract' (2002) 13 *Stanford Law & Policy Review* 233.

flexibility and qualitative norms in many areas of business. Such a law is not wildly uncertain. As Llewellyn said,

For the fact is that the work of our appellate courts all over the country is reckonable. It is reckonable first, and on a relative scale, far beyond what any sane man has any business expecting from a machinery devoted to settling disputes self-selected for their toughness. It is reckonable second, and on an absolute scale, quite sufficiently for skilled craftsmen to make usable and valuable judgments about likelihoods, and quite sufficiently to render the handling of an appeal a fitting subject for effective and satisfying craftsmanship.⁶⁶

Yet it is also true that in some situations more formality and relatively clear default rules may be justified. However, we have only begun to look for those areas. One factor pointing in this direction is when parties are represented by lawyers, the document reflects real negotiation and parties and lawyers worried at the outset about the consequences of failure of performance and disrupting events such as wars, depressions and terrorism. Perhaps paradoxically another area might be consumer transactions where one side almost certainly will not be represented by lawyers. Clear rules here might cut the costs of consumers seeking remedies; consumers can seldom afford to battle about reasonableness and unconscionability when the product in issue cost only a few thousand dollars.⁶⁷

'And now for something completely different': Ian Macneil and relational contract theory

If we are concerned about implied contracts and the text between the lines, the new formalists are not the only American scholars whom we should consider. Ian Macneil has, for over 30 years, championed relational contract theory.⁶⁸ He contrasts long-term continuing relationships with the discrete transactions often assumed by earlier writers and many common law judges to be the form of all contracts. Empirically, many of us have shown that the continuing relationship is extremely common.⁶⁹ Relationships have their own normative systems backed in

⁶⁶ See Llewellyn above, n16 above, 4.

⁶⁷ See W. C. Whitford, 'Contract Law and the Control of Standardized Terms in Consumer Contracts: An American Report' (1995) 3 *European Review of Private Law* 193, 203, 207. In some American states, however, consumers can make effective use of small claims courts and various administrative tribunals. Here qualitative standards might help consumers because the decision making tends to be intuitive. Many American suppliers of consumer goods have attempted to avoid this type of informal dispute resolution by providing for compulsory arbitration in their standard form contracts. Sometimes arbitration is an alternative form of dispute resolution selected in good faith; often, however, it is just a ploy to ward off claims when the manufacturer selects the arbitrator and names a place for arbitration far from most consumers.

⁶⁸ See D. Campbell (ed), *The Relational Theory of Contract: Selected Works of Ian Macneil* (London: Sweet & Maxwell, 2001); D. Campbell, 'Ian Macneil and the Relational Theory of Contract' in *ibid* 3; D. Campbell and D. Harris, 'Flexibility in Long-term Contractual Relationships: The Role of Co-Operation' (1993) 20 *Journal of Law and Society* 166.

⁶⁹ See eg S. Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55; S. Macaulay, 'Elegant Models, Empirical Pictures, and the Complexities of Contract' (1977) 11 *Law & Society Review* 507; S. Macaulay, 'An Empirical View of Contract' (1985) *Wisconsin Law Review* 465; H. Beale and A. Dugdale, 'Contracts Between Businessmen' (1975) 2 *British Journal of Law & Society* 45; B.-M. Blegvad, 'Commercial Relations, Contract, and Litigation in Denmark: A Discussion of Macaulay's Theories' (1990) 24 *Law & Society Review* 397. D. Jutras, 'The Legal Dimensions of Everyday Life' (2001) 16 *Canadian Journal of Law and Society* 45, summarises in English, J. G. Belley, 'Le

complex ways by sanction systems. Most simply, if parties are to continue the relationship, this may call for many adjustments of rights and duties over time. The risk of losing the relationship usually is a powerful sanction. Insofar as contract law rests on reasonable expectations and reliance, the relational nature of a transaction calls for a different kind of contract law. Such a law would recognise the implicit dimensions of contracts.

Macneil draws an analytic distinction between discrete and relational contracts. Discrete contracts are abstract statements of the total obligation. The parties bring the future to the present and enter a contract that will define their obligations to each other. Context is unimportant. The parties may not have dealt before, and there is no assurance that they will deal again. Relational contracts, typically, are not specific and precise allocations of risk. They involve complex transactions, and often it is hard to determine when they begin and are to end. They are agreements to cooperate to achieve mutually desired goals.

In a well-known passage, Gordon tells us that in relational contracts:

parties treat their contracts more like marriages than like one-night stands. Obligations grow out of the commitment that they have made to one another, and the conventions that the trading community establishes for such commitments; they are not frozen at the initial moment of commitment, but change as circumstances change; the object of contracting is not primarily to allocate risks, but to signify a commitment to cooperate. In bad times parties are expected to lend one another mutual support, rather than standing on their rights; each will treat the others insistence on literal performance as willful obstructionism; if unexpected contingencies occur resulting in severe losses, the parties are to search for equitable ways of dividing the losses; and the sanction for egregiously bad behavior, is always, of course, refusal to deal again.⁷⁰

All human exchanges, Macneil asserts, involve norms. Some are internal to the exchange; others are external. Some norms are more appropriate to discrete transactions. For example, implementation of planning and obligations limited to the boundaries of consent fit more discrete deals. Other norms fit relational ones better. Here values such as maintaining the integrity of roles within the relation and maintaining the relationship itself are all important. Furthermore, more complex relationships can call for harmonising the arrangement with the surrounding social matrix. However, Macneil's theory recognises that norms and sanctions can be applied by legal and other-than-legal institutions and

Contrat entre Droit' (1998) *Économie et Société*, which was published only in French. Jutras says: Belley studied ALCAN, and he tells the story of a transformation of the economic culture of corporations, from the traditional culture of relationships of trust, confidence and interdependence to a modern, technocratic culture of quality control and coordination, driven by fixed objectives of growth. Previous scholarship had emphasised the importance of implicit norms and personal bonds of trust in long-term commercial contracts. Belley underlines the unresolved tension created in those contracts by the introduction of the depersonalised logic of expert system and explicit parameters of production. Supply contracts at ALCAN are very much explicit, but Belley's research shows that the behaviour of parties in circumstances of uncertainty is guided by unspoken shared assumptions that make up underlying cultures of the contract. There is a plurality of such cultures, which together provide structure and depth to the terms of interaction between ALCAN and its suppliers. Next to the juridical culture of the explicit contract, there is, in particular, an economic culture of profitability and pragmatism, at once traditional (resting on interpersonal bonds of trust) and modern (resting on the cold technocratic comfort of expert systems). Furthermore, the process of explicit articulation of the terms of cooperation necessarily affects the implicit culture of the relationship.

⁷⁰ R. Gordon, 'Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law' (1985) *Wisconsin Law Review* 565, 569.

organisations. There are costs to imposing norms by formal legal means. Sometimes it makes sense to pay this price; often it does not.

When we turn from theoretical constructs to looking at the world of buying and selling, we discover that matters are not so neat as a spectrum ranging from the discrete to the relational. We can debate whether there are any real world discrete transactions: Parties must have some sort of relationship in order to have at least the minimum of trust needed to bargain. Even in close relationships, moreover, parties usually do not leave everything to be worked out as they go. Moreover, sometimes the parties will structure a transaction as if it were a discrete one despite its relational elements. Sometimes the party with greater power wants a relationship based on trust and cooperation but also wants to reserve the power to hold the other to the letter of a written document when it is to its advantage.

What does this mean for law? Several writers have called for a new relationally based system of contract doctrine.⁷¹ Courts would look to standards based on Macneil's rich classificatory scheme of internal and external contract norms. Feinman suggests that such an approach would look less like typical doctrinal method and more like policy analysis.⁷² Other scholars have worried whether courts would be capable of supervising the good faith of those in a relationship, and whether, if courts tried to do this, it would create major problems for those trying to plan what risks to assume and which to avoid. Trebilcock, for example, argues that Macneil's relational approach cannot 'yield determinate legal principles' because it 'entails a highly amorphous sociological inquiry that seems well beyond the competence of courts in case-by-case adjudication.'⁷³ The key phrase in Trebilcock's criticism is 'determinate legal principles'. Macneil's writings raise the question whether a court could deal with a highly relational contract by using determinate legal principles. However, Macneil would accept that in some situations courts should treat what are in fact relational transactions *as if* they were discrete. When such a fiction is appropriate, determinate legal principles might be appropriate. The hard part, as I have said, is deciding when courts should honor the work of a corporate lawyer which she has labeled 'contract' when there is only second class consent, if that.

Would a relational approach be 'well beyond the competence of courts in case-by-case adjudication?' If we think that any trial in an adversary system is more than a comforting ritual, we might ask why the principles of relational contract theory are any more difficult or amorphous than, for example, deciding whether to impose the death penalty or to remedy Microsoft's violation of the antitrust laws by breaking up the corporation. This is not to deny that flexible approaches often present daunting problems for lawyers and judges. There is a

71 See the debate between Peter Linzer, Steven J. Burton and Jonathan Eddy in 1988 *Annual Survey of American Law* 137. Whitford says: 'Macneil believes the legal system needs to take radically different approaches to relational contracts than it traditionally has. In dealing with disputes, he favours greater reliance on procedures oriented toward mediation and less emphasis on adversary processes looking toward adjudication. In regulating contracts, he counsels greater reliance on proactive administrative agencies that can take account of the many third-party interests at stake and less reliance on courts able to apply regulatory rules only when a disadvantaged party initiates a court procedure.' W. C. Whitford, 'Ian Macneil's Contribution to Contracts Scholarship' (1985) *Wisconsin Law Review* 545, 551.

72 J. M. Feinman, 'Relational Contract Theory in Context' (2000) 94 *Northwestern University Law Review* 737.

73 M. J. Trebilcock, *The Limits of Freedom of Contract* (Cambridge, MA: Harvard University Press, 1994) 141-142.

capability problem, and high cost barriers stand before putting on a case to be judged by standards such as reasonableness. Yet there is no reason to presume that courts will always get it wrong, apart from one's faith in an anti-government ideology.

A limited trace of optimism: the real deal resting on relational norms can be supported by courts inducing settlements rather than announcing judgments.

Perhaps we should not conclude too quickly that the moral of my story is damned if you do and damned if you don't. While there is more to law than just legal rules, doctrine can matter. I applaud the efforts of those attempting to give us better conceptual tools. We will, however, do better if we attempt to fashion doctrines more or less suited for specific types of contracts rather than trying to fabricate one grand contract law. Nonetheless, doctrine rests on assumptions about the society and its proper organisation. Brownsword tells us:

There are two plausible ethics for contract law, individualism and cooperativism... It is not easy for contract doctrine (whether through notions of good faith, unconscionability, reasonableness, loyalty, legitimate expectation, or whatever) to hold strictly to either of these ethics in their most robust form. Doctrinal adherence to individualism will often seem out of touch with business practice (where compromise, adjustment, and partnering and the like govern dealings); but, equally, doctrinal adherence to cooperativism can put too great a strain on the idea of a common enterprise (at any rate, in the sense of an identity of interest).⁷⁴

But Americans always want to eat their cake and have it too: We want both individualism and cooperativism at the same time. We bounce back and forth through cycles where we emphasize one and then the other. Yet it is a question of emphasis: words rationalising individualism are still there when our legal culture accepts more cooperativism. The one safe statement about American contract law in action is that it is messy.

In some situations, there is no reason to think that courts will not be able to do as well in a contract case as they do in any other type of case. If we impose duties of cooperation or tell a court to give a remedy 'if injustice can be avoided only by enforcement of the promise',⁷⁵ our legal system often will reach at least acceptable results. Assuming that cost barriers permit, lawyers may be able to show judges what would be fair in a particular commercial context. The judges and the lawyers involved might never define 'fair' in a precise fashion that would satisfy a critic or offer answers to judges and lawyers in future cases. Nonetheless, all involved might accept that the results seemed to fall within an intuited zone of fairness. This process, however, might be very costly because it could require an exploration of the full commercial context. Of course, there is a risk that the judges might get it wrong, and cost barriers to proving the full context of a transaction would likely increase that risk. However, there is no reason to presume that the process always will be unduly costly or judges will always get it wrong. Perhaps if we conclude

74 R. Brownsword, 'Individualism, Cooperativism and an Ethic for European Contract Law' (2001) 64 *Modern Law Review* 628, 630.

75 Contracts scholars will recognise that the quoted phrase is a key passage in the American Restatement (2d) Contracts §90.

that there is a problem in a type of case such as those involving consumers, we should advocate flat rules for those kinds of situations.

We can consider an example both of what can be done and some of the limitations. An Ohio trial court filled substantial gaps in a long-term contract in *Oglebay Norton Co v Armco Inc*⁷⁶ The firms had close long-term continuing relations: Oglebay Norton ran iron ore boats on the Great Lakes, and it managed the Eveleth iron ore mining operation in Minnesota. Armco was a major steel producer, and it owned one third of the Eveleth operation. Armco had a seat on Oglebay Norton's board of directors. In 1957, the firms entered a contract that required Oglebay to have adequate shipping capacity available for Armco. Armco was to use this shipping capacity if Armco wished to transport iron ore from mines in the Lake Superior district to Armco's plants in the lower Great Lakes region. Armco was to pay 'the regular net contract rates for the season as recognised by the leading iron ore shippers in such season.' If there were no such regular net contract rate, 'the parties shall mutually agree upon a rate for such transportation, taking into consideration the contract rate being charged for similar transportation by the leading independent vessel operators engaged in the transportation of iron ore from the Lake Superior District.'

During the next twenty-three years, the parties modified the contract four times. They continued to extend its duration until it finally ran until 2010. In 1980, they agreed that Oglebay Norton would upgrade its fleet to give self-unloading capability to each vessel used to haul Armco ore. To help pay for this large capital investment, Armco agreed to pay an additional twenty-five cents per ton shipped in the self-unloading vessels. From 1957 to 1983, Oglebay Norton based the price charged Armco on the rate published in *Skillings Mining Review*, a trade journal that gathered this information. In 1983, Armco, as was true of all American steel producers, had suffered heavy losses because of competition from foreign steel mills. The *Wall Street Journal* reported that 'Armco had a \$295 million loss in 1983, bringing total losses for the last three years to about \$1.3 billion.'⁷⁷ Armco negotiated lower rates from Oglebay Norton for 1983. The parties, however, were unable to negotiate a rate for 1984 and 1985. Oglebay Norton billed Armco for ore shipped, but Armco rejected this bill and paid much less than Oglebay had demanded. To further complicate matters, after 1985, *Skillings Mining Review* no longer published rates for shipping iron ore on the Great Lakes.

In 1986, Oglebay Norton sued for a declaratory judgment. 'After a lengthy bench trial,' the trial court made findings of fact and law. It found that the parties had intended to make a binding contract although the shipping rates were not settled. In such a case, the rate is a reasonable price. The court found a rate for the 1987 season. To do this, it listened to the testimony of a person who was an economic and financial expert about freight rates on the Great Lakes. It had data about what Armco had paid in the past few years, and information about the rates that Oglebay Norton had quoted as the price for carrying Armco ore. It had evidence of what one of Armco's competitors had paid. The trial court selected a rate that fell within the range of rates in evidence. Finally, the trial court ordered the parties to negotiate rates during the rest of the life of the contract. If they could not reach agreement, the parties were ordered to ask the court to appoint a mediator and to cooperate in mediation. The Supreme Court of Ohio affirmed this decision.

⁷⁶ 52 Ohio St.3d 232, 556 N.E.2d 515 (1990).
⁷⁷ *Wall Street Journal* 28 March 1985.

We can notice several things about the *Oglebay Norton* case. The reasonable rate was not a thing that existed in the world that could be just picked up and plugged into the contract. The trial court had to exercise judgment and create the rate based on information in the record. We do not know anything about the expert who testified at trial. How did he know what was being charged for Great Lakes shipping of this cargo? In 1996, a magazine story pointed out that there was not much competition among shipping companies because the steel companies owned their own fleets or were closely associated with particular operators of ore boats. The story commented: 'Rates in the laker trade are difficult to get ahold of. Published rates are nothing more than a starting point, and with such an incestuous relationship between shippers and carriers, no one talks about what they actually pay.'⁷⁸ Oglebay Norton tried to subpoena information about rates from independent vessel operators and captive fleets, but the trial court quashed these subpoenas before trial because Oglebay had no right to this proprietary information. Thus, the court had to use its judgment without precise information when it established a rate. Nonetheless, there is no reason to think that there was anything drastically wrong with the price that the court set.

American contracts scholars might find the order to negotiate and then mediate future freight rates surprising. The contract had about twenty-two more years to run, and the court sought to support the relationship as best it could. If we assume that the relationship would continue more or less as it had in the past, the court's approach seems reasonable. Oglebay Norton, after all, had invested in self-unloading ore boats at Armco's request. The contract had not been in effect long enough after this major investment so that the extra payment per ton of iron ore would have covered this expense. The mediator could have reinforced a duty to negotiate in good faith.

We do not know how well this structure worked. We know that the parties continued a business relationship at least until 1995, because Oglebay Norton's Annual Report for that year stated that it had supplied advanced technology for Armco's new continuous casting mill. However, all the effort of the Ohio courts probably failed to keep the Great Lakes shipping relationship alive in anything like its former state. Throughout the 1980s, the American steel industry faced great financial difficulty. In 1989, Armco sold much of its carbon steel making capacity to a joint venture it formed with a Japanese steel company. We can suspect that Armco had fewer, if any, requirements for hauling ore on the Great Lakes. Armco focused on making stainless steel: 'Armco buys domestic steel and limited amounts of imported steel - including Japanese steel - to convert into pipe and tube at its downstream plants. Armco used to make the steel itself but now makes exclusively specialty steels....'⁷⁹ In 1992, Armco bought about two thirds of its now reduced requirements of ore from the Eveleth facility managed by Oglebay, but it bought the rest at a much cheaper price from Brazil. The Brazilian ore was shipped on barges up the Mississippi River to the Ohio River and then to Armco's plants. This ore did not come under the contract with Oglebay Norton.

Instead of having to negotiate a price, with any disputes subject to mediation, it seems likely that Armco changed its way of doing business so that it needed much less, if any, ore hauled from mines in the Lake Superior region on the Great Lakes.

⁷⁸ P. F. Conlye, 'A Long Season Ends for Great Lakes Fleet' *Journal of Commerce* 29 February 1996, 18.

⁷⁹ T. W. Gerdel, 'Oglebay Norton Lays Off 140 at Ore Mine' *Cleveland Plain Dealer* 11 December 1992, E-1.

When issued, the court's order to negotiate and mediate seemed reasonable enough. After just a few years, the changes at Armco seemed to have meant that Armco no longer had as many requirements for carrying ore on the Great Lakes. But this was a risk that Oglebay Norton assumed when it made a requirements contract. If our speculation is right, the court's order made sense as long as a requirements contract made sense. The court could not change the decline of the American steel industry.

Macneil has pointed out that there are situations where it is in the interest of the parties, and even perhaps of the economy as a whole, where the law should treat parties *as if* their relationship was discrete and entirely contained within the borders of a written document. The task is to identify such situations. One approach is to submit such documents to a regulatory agency for approval, such as is often done with insurance policies. This seems to be a sensible solution as long as we are confident that the regulatory agency will not be captured by trade associations that make campaign contributions. We have long distinguished consumer transactions from those between merchants. Yet even this leaves me uneasy; it seems too crude. Some transactions between businesses have many elements of a consumer transaction. Often a franchise agreement is one-sided and written by the more powerful party. Often these agreements or amendments to them are hard to read and understand. Perhaps courts can approach documents such as franchises as if the relationships involved were discrete. They may be able to do this because those involved can gain legislation that calls for a more relational approach to the legal rights of the parties. Courts can avoid the difficulties involved in a relational approach unless a legislature determines that it is worth the costs of attempting to reinforce the norms of cooperation. Yet, here too, we would be more comfortable if we had more faith in our American legislatures as something other than places where law is sold to the highest bidder.⁸⁰

Whatever our success in identifying places for treating relationships as if they were discrete, we must remember that it is not just a question of legal doctrine. Doctrine does not have little legs so that it can hop down from law books and enforce itself. Doctrine is delivered in an extremely expensive system for which someone must pay. Often the reason that a transaction broke down is that one side lost the ability to perform because it ran out of money. A claim in bankruptcy often is not worth the effort. Even when there is little risk of bankruptcy, suing someone usually destroys relationships and invites retaliation.

We might be happier if we took a lawyer's perspective and saw the game as one involving acceptable, if not ideal, settlements. While not all cases can be nor should be settled, more often than not the 'least bad' solution is a compromise fashioned in light of the situation facing the parties at the time of the dispute. Many, if not most, settlements fall beneath the radar screen of contract scholars. Publishers do not deliver reports of these cases to our door or to our computer. The parties often want their settlement to be secret. However, parties do invoke the legal system as part of a strategy to produce settlements. When cooperative

⁸⁰ Special interest pressure has even moved from the public legislative arena to the National Conference of Commissioners on Uniform Laws, the group that proposes revisions to the Uniform Commercial Code. See R. E. Speidel, 'Introduction to Symposium on Proposed Revised Article 2' (2001) 54 *SMU Law Review* 787; R. E. Speidel, 'Revising UCC Article 2: A View from the Trenches' (2001) 52 *Hastings Law Review* 607; A. Schwartz and R. E. Scott, 'The Political Economy of Private Legislatures' (1995) 143 *University of Pennsylvania Law Review* 595.

approaches fail, letters can be written on an attorney's letterhead in order to make an implicit threat. Complaints may be filed in court, and negotiations may be commenced if summary judgment is not granted. Sometimes, however, cases involving large sums of money may proceed far down the path to a final judgment affirmed on appeal and still be settled. Furthermore, sometimes the settlement provokes the parties to resume their relationship, although often with a modified balance of power. This may be a way, if not the most common way, that the ideas of relational contract are implemented in the American legal system.

What appears to be a final judgment at the trial level may be only a step toward settlement. The judgment may affect the balance of power between the parties, but often it will not go into effect as written. For example, the judge in *Aluminum Corporation of America v Essex Group Inc.*⁸¹ rewrote an escalator clause to express what he saw as the actual risk distribution between the parties. This was an implicit dimension of this relationship. The opinion was highly controversial, but none of the academic writing about it considered the final outcome of the case. ALCOA and Essex entered a toll conversion contract in 1967 that was to run until 1983. In form, this was a services rather than a sales contract. ALCOA would convert Essex' ore into molten aluminum, and Essex would receive it in this form. Essex made the contract when it decided to expand its manufacturing of aluminum wire products. The court said: 'The long term supply of aluminum was important to assure Essex of the steady use of its expensive machinery. A steady production stream was vital to preserve the market position it sought to establish. The favorable price was important to allow Essex to compete with firms like ALCOA which produced aluminum and manufactured aluminum wire products in an efficient, integrated operation.'⁸²

ALCOA had drafted an escalator clause to set the price for the aluminum that it processed. The escalator was tied in part to the federal government's Wholesale Price Index-Industrial Commodities. The WPI-IC failed to reflect an unexpected rapid increase in the cost of electric power. 'Electric power is the principal non-labor cost factor in aluminum conversion, and the electric power rates rose much more rapidly than did the WPI-IC.'⁸³ Moreover, there was a sharp increase in the demand for aluminum. Essex did not use the material delivered by ALCOA in the manufacture of wire products. Instead, it resold millions of pounds on the market. In June of 1979, the cost to Essex of the ALCOA product was 36.35 cents per pound, but Essex was reselling on the market at more than 73 cents per pound.

The court found that ALCOA was excused from performing the contract under the doctrines of mutual mistake, impossibility and frustration. The court decided that while ALCOA necessarily had taken some risk in entering the contract which it thought that it had covered by its escalator clause, the actual result was not within the zone of risk that it had assumed. The escalator did not serve to create a price that would give ALCOA 'the minimum return of one cent per pound which the parties had contemplated.'⁸⁴ However, the court thought it unfair to excuse ALCOA entirely from its obligations under the contract. It said:

To decree rescission in this case would be to grant ALCOA a windfall gain in the current aluminum market. It would at the same time deprive Essex of the assured long term

⁸¹ 499 F. Supp. 53 (WDPa 1980).

⁸² *Ibid* at 58.

⁸³ *Ibid*.

⁸⁴ *Ibid* at 66.

aluminum supply which it obtained under the contract and of the gains it legitimately may enforce within the scope of the risk ALCOA bears under the contract.⁸⁵

The court decided that the contract price would be the smallest produced by one of three ways of computing it, including the original formula found in the written document. Importantly, one method was 'the price which yields ALCOA a profit of one cent per pound of aluminum converted.' Unless the price of aluminum fell significantly, the judge had transformed the agreement into a cost plus a percentage of profit contract. However, ALCOA was not freed of all obligations under the contract. Also, Essex could not continue to resell its aluminum to other users of the product at the market price while paying only the very low contract price.

For my purposes, the important thing to notice is that the judge's formula never went into effect. The parties settled after Essex appealed, and the appellate court had heard oral argument. As part of the settlement, the original contract remained in effect until 31 December 1981. It was extended for five years beyond the end of 1981. During the balance of time remaining from the date of the settlement to the new termination date, ALCOA would sell to Essex at a favorable price, but not one as favorable as Essex enjoyed through 1981. We can see the ultimate resolution of the dispute as very relational. The parties continued their relationship and provided for a transition bringing it to an end. Essex, to a large extent but not entirely, had to stay in its role under the original allocation of risks. It was buying aluminum in order to make aluminum wire products. It was not entitled to act as a middleman, capturing the gains from low cost sheets of aluminum which it could sell on the market. Essex had some duty to pay attention to ALCOA's interests. Rather than maximizing its own return, the implicit dimension of the relationship required Essex to cooperate to accommodate their mutual interests.

What was the contribution of Judge Teitlebaum in achieving such a relational end? Essentially, he acted as a mixture of mediator and arbitrator. He found what he saw as a fair solution on the basis of the facts presented to him. When mediators offer their solutions to a problem, often it triggers successful negotiations. The mediator's solution is where the bargaining begins, and it may be very useful to the parties who are constrained by negotiation tactics. However, Judge Teitlebaum's solution was more than just a suggestion. It would go into effect unless the parties found a better one. Of course, Judge Teitlebaum's revised escalator clause might not go into effect if Essex were able to persuade an appellate court to overturn it. ALCOA had won a victory, but it rested on an opinion that certainly pushed the envelope. If the appellate court were staffed by judges who had faith in classic contract law, ALCOA could lose. Yet Essex could not be sure that it could get Judge Teitlebaum's revisions overturned, and it faced both delay in resolving the matter and the costs of the appellate process. It might appeal, wait, and invest a great deal in lawyers' fees, only to have Judge Teitlebaum's opinion affirmed. It was even possible that the appellate court would have reversed the trial court but written an opinion that would make Essex worse off than the Teitlebaum escalator clause.

Did Judge Teitlebaum reach a good solution? Our appraisal must turn on our judgment as to whether ALCOA took the risk in this contract of having Essex go into competition with ALCOA in the general market for sheets of aluminum. If we

⁸⁵ *Ibid* at 84.

see the contract in substance as one calling for ALCOA to supply Essex's requirements of the raw material needed to manufacture aluminum wire products with its expensive machinery, the implied dimension of this contract seems clear enough. It is hard to see why ALCOA should be burdened with the risk of supplying Essex with ridiculously low priced aluminum which Essex could sell in competition with ALCOA's own sales in that market. While Judge Teitlebaum may have been mistaken in the formula that he imposed on the parties, they were not stuck with it. They were able to fashion one that they thought would better their situation.⁸⁶ The next two examples involve Westinghouse's attempt to become the dominant corporation in supplying nuclear power plants. We have to put ourselves back to those wonderful days when the peaceful atom was going to supply endless clean power. However, fossil fuels were cheap, and nuclear power plants were expensive. Westinghouse had to convince reluctant utility executives to invest in what was being sold as cutting edge technology. In the first group of cases, Westinghouse sweetened the deal to sell reactors by promises to supply fuel at a fixed price which was far above the market when they made the contracts. The utility executives could have felt comfortable because the fuel could never cost more than the price fixed in the contract, but it was likely to cost a great deal less. An international cartel formed to fix uranium prices, and it succeeded for a time. Now Westinghouse was being called on to supply fuel at extremely high prices. The newspapers of the time said that Westinghouse simply could not buy all the fuel it had promised to supply at the cartel price. Westinghouse notified its utility customers that it would not supply the fuel, but it claimed to be excused under the Uniform Commercial Code's impossibility provision. Section 2-615(1)

⁸⁶ Attempts to rework the obligations of parties in a complex relationship can burden courts and litigants. For example, in *B.P. Exploration Co v Hunt*, [1979] 1 WLR 783, aff'd [1982] 1 All ER 925, the court dealt with a qualitative statute that gave little more direction than calling for compensation for benefits conferred and allowing retention of some or all of a down payment if the court 'considers it just to do so having regard to all the circumstances of the case.' See the Law Reform (Frustrated Contracts) Act, 1943 (6 & 7 Geo. 6, c. 40). The case involved a complex transaction in the oil industry. Nelson Bunker Hunt owned a concession in Libya. B. P. Exploration agreed to develop the concession, and the two were to share equally the oil produced. Hunt was to pay for his share of the development costs from his share of the oil produced. The concession was expropriated, and the court had to consider offsetting claims.

Justice Goff wrote a 67-page opinion. He noted there:

[I]n addition to difficult and novel questions of law, the case involves substantial questions of fact and of accounting procedure. The sums involved are enormous; B. P.'s claim was advanced in a number of alternative ways, the sum claimed varying from nearly \$45,000,000 to nearly \$230,000,000. Furthermore, allegations made by Mr. Hunt related to the manner in which B. P. developed the oil field led to an investigation of almost the entire history of the exploration, appraisal, and development of the field, and the production of oil from the field. This investigation required a substantial body of evidence, much of it technical; and the documents before the court, which were very largely concerned with these allegations by Mr. Hunt, were very numerous - I was told that there were over 15,000 documents in court. Many of these were of a technical nature; and in any event they represented only the tip of the iceberg of documents disclosed on discovery. Only by reason of the good sense and restraint shown by counsel on both sides, and the efficiency of their instructing solicitors, was it possible for a so substantial piece of litigation to be kept under control and for the hearing to take no longer than 57 days.

After this elaborate procedure, and without much explanation, the judge accepted B. P.'s claim that half the benefit was attributable to its actions and half to Hunt's. This served to make the final judgment something of a rough split-the-difference compromise. Donald Harris, David Campbell and Roger Halson, *Remedies in Contract & Tort* 246-254 (2d ed 2002), are, 'with greatest respect,' very critical of this decision. They judge it 'thoroughly painstaking but ... undeniably unsatisfactory...' Perhaps the only way to defend the process and the result is to notice that Nelson Bunker Hunt is a Texas oil man. While more conventional wealthy people might have worked out a settlement with B.P. Oil, only a 'shoot-out at the okay corral' would satisfy him. The process can be viewed as an elaborate social ritual for the privileged. It is highly unlikely that any American federal court would have invested this amount of time and effort in any contract case today.

grants an excuse 'if performance as agreed has been made impracticable by the occurrence of a contingency the non-occurrence of which was a basic assumption on which the contract was made ...'⁸⁷ The cases were consolidated before United States District Judge Robert Merhige, Jr. Judge Merhige was known as a settling judge who wanted the parties to solve the problems rather than litigate. The day the trial opened, he told the many lawyers assembled in his courtroom, 'I don't ever expect to finish these cases.... I expect [them] to get settled.'⁸⁸

Judge Merhige's biographer⁸⁹ tells us:

In an attempt to facilitate settlement discussions, Merhige and his wife hosted cocktail parties in their home for the lawyers and the corporate executives. It may not have been a crucial factor, but the social contact did facilitate discussions in a context other than confrontational litigation. Westinghouse Chairman Robert E. Kirby finally agreed to become involved in the negotiations and made personal contact with the chief executive officer of each utility. The jawboning paid some immediate benefits when six of the thirteen utility companies reached a settlement with Westinghouse before the conclusion of the trial. The other utilities, however, remained adamant...

Utilising his expertise in alternative dispute resolution, Merhige offered each party a carrot and a stick. The utilities received an important bargaining chip with Merhige's recognition that Westinghouse was subject to some liability. By warning the utilities that they would not receive the full damages they sought, Merhige significantly strengthened Westinghouse's bargaining position.... He increased the pressure on the parties to negotiate by announcing that the court would meet and confer with counsel in an effort to assist them in reaching an agreement...

Merhige once again increased the pressure to compromise by escalating the length and frequency of the negotiation conferences. Out-of-town lawyers were astonished when the judge insisted that they come to court on weekends, early mornings and late evenings. At one point, Merhige threatened to have counsel work on 'Saturdays, Sundays, and some days that aren't even on the calendar'...

Lewis Booker, liaison counsel for the utilities ... said that: Judge Merhige was very astute in recognising that the parties and the experts could negotiate on matters that a judicial verdict could not cover. For example, the utilities could agree to accept a turbine generator in lieu of damages, but Merhige would have been powerless to order that. His verdict would necessarily have been limited to computing dollar damages. ...⁹⁰

Judge Merhige appointed a law school dean as a special master to assist the parties in reaching an adjustment of the respective claims. Merhige required the parties to file proposals for settlement. In most cases, the settlements reached did not require Westinghouse just to pay cash to its customers as damages. Rather, the settlements involved a combination of cash and services. Often Westinghouse agreed to provide services maintaining the nuclear reactors and supply

87 The Official Comment is perplexing. On one hand, it tells us: 'a rise or a collapse in the market [is not] in itself a justification [for not performing], for that is exactly the type of business risk which business contracts made at fixed prices are intended to cover.' This would seem to favor the utility buyers. On the other hand, the Comment continues: "But a severe shortage of raw materials or of supplies due to a contingency such as war, embargo, local crop failure, unforeseen shutdown of major sources of supply or the like, which either causes a marked increase in cost or altogether prevents the seller from securing supplies necessary to his performance, is within the contemplation of this section.' Obviously, Westinghouse liked this last part but wanted to downplay the first.

88 Pappas, 'Westinghouse, Utilities Under Pressure to Settle Uranium Suit Before Court Does' *Wall Street Journal*, 2 June 1978, 32.

89 R. J. Bacigal, *May It Please the Court: A Biography of Judge Robert R. Merhige, Jr.* (Latham, MD: University Press of America, 1992).

90 *Ibid* at 145, 146-147.

replacement parts at a deeply discounted rate. In the Texas Utilities Services Inc case, the settlement was contained in a 350 page agreement. It was estimated to be worth \$80 million to the utility, but the out of pocket cost to Westinghouse was only \$27 million. Westinghouse assigned some of its claims against the uranium cartel to its customers as another way of sharing potential gains and losses. Most of the settlements reinforced the relationships between Westinghouse and its customers who had a Westinghouse nuclear reactor to run for many years.

Again observers who knew something about nuclear energy thought that Westinghouse had settled all of the utilities cases for about half of what they had claimed.⁹¹ Stewart reports: '[i]f Westinghouse and the utilities had simply split their differences in 1975, before resorting to litigation, the result would have been about the same.'⁹² However, the parties could not have done this without going through something like the process that took place in and out of Judge Merhige's courtroom. Many utilities were hesitant to settle without establishing that they had given nothing away. At the time of this litigation, these power companies were regulated, and a regulatory commission would have to be satisfied with the settlement. Moreover, some of Westinghouse's customers hesitated to settle early in the process because they did not want utilities that negotiated later to get larger amounts and make the pioneers look as if they had sold out too cheaply. The law school dean was able to help manage the work with the large group of buyers and keep the pressure on both sides to solve the problem. The dean was a mediator who always had the power of the trial judge as a potential sanction.

The settlements at least attempted to further the interests of both seller and buyers. Westinghouse managed to avoid the crushing liability that a literal application of its many contracts with customers would have imposed. Yet Westinghouse was able to keep alive relationships that might prove to be profitable. The utilities kept alive the relationship so that there would be someone who could service and maintain the reactors. We cannot be sure, but it seems that this outcome was better than the utilities could have gained had they been able to win judgments enforcing their contract rights. It is likely that all this would have done was force Westinghouse into bankruptcy, and as unsecured creditors the utilities would not have done well in such a proceeding. The liaison counsel for the utilities told Judge Merhige's biographer:

The overall feeling by everyone was that justice had really been done. The utilities got what they needed to continue operations, while Westinghouse was able to avoid bankruptcy, keep its plants running and its people employed...⁹³

In the next example, Westinghouse closed its deal with Florida Power and Light Company by offering another sweetener in the negotiations that ultimately provoked litigation.⁹⁴ Westinghouse promised to remove the spent rods of

91 See J. B. Stewart, *The Partners: Inside America's Most Powerful Law Firms* (New York: Simon and Schuster, 1983) 153.

92 *Ibid* 198.

93 Bacigal, n 89 above 148. See also D. Campbell and D. Harris, 'Flexibility in Long-term Contractual Relationships: The Role of Co-Operation' (1993) 20 *Journal of Law and Society* 166, 172: 'Once freed from the panic of the oil crisis and the competitive suspicion and hostility into which the mutually destructive idea of holding Westinghouse to its contracts or of Westinghouse abandoning its buyers led, a sensible co-operative adjustment to the changed circumstances took place.'

94 See *Florida Power and Light Co v Westinghouse Electric Corp* 517 F. Supp. 440 (E. D. Va. 1981).

uranium from FP&L's holding ponds into which the rods were placed. Westinghouse had planned to recycle these rods, but no commercial recycling was available in the United States. The United States Government represented that such reprocessing would be available, but it never brought this about. Once again, the case was tried by Judge Merhige. This time he issued a decision holding that Westinghouse was not excused under Section 2-615(1) of the UCC. FP&L had asked for a decree of specific performance ordering Westinghouse to remove the rods. Judge Merhige said: '[W]hile the court is fully cognizant of the difficulty of fashioning a sufficiently specific decree should the parties be unable to reach agreement, and should the Court conclude that specific enforcement is appropriate considering various other factors, the Court believes that, with the assistance of the parties, a workable and appropriate decree would be achieved.'⁹⁵ The judge then granted the parties 90 days in which to attempt to agree on a settlement. The parties were directed to select experts to aid the court. The judge said: 'both parties are urged to use the initial time period in an intensive attempt to reach agreement rather than in preparing to further litigate the issue of remedy.'⁹⁶

The parties failed to reach agreement.⁹⁷ Nonetheless, they had appointed a committee of nuclear engineers who studied the situation. These engineers determined that it was possible to rerack the nuclear facility's holding ponds. As a result, all the rods that would be produced during the designed life of the plant could be stored there. The reactors would not have to shut down when the ponds were full. FP&L would not have to buy power to substitute for that generated by this plant. Westinghouse agreed to do the reracking at no cost to FP&L. Judge Merhige decided that there should be an equitable allocation of the interim costs of storing the spent rods. After the dispute arose, Congress had passed a statute that called for the construction of a permanent storage facility for all nuclear waste. While then it looked as if the problem might be solved after the litigation ended, Americans are still battling about what to do with nuclear waste. Judge Merhige also allocated the other costs. He took into account that while utility customers elsewhere had paid high rates for electricity produced by fossil fuels, FP&L's customers had not. His allocation was roughly an equal division of various costs.⁹⁸

Again, we see something of a relational approach to the problems. By convening a panel of engineers, the judge managed to produce a technical solution to a major part of the contract problem. The final result reinforced the continuation of the relationship. The decision required both sides to cooperate in the future.

Which approach is better? Will we get more and better settlements if trial judges rewrite contract clauses that might or might not be overturned on appeal? Will we get more and better settlements if a judge takes over negotiations and presses the parties to work out a deal? The answer again is not clear. My guess is that sometimes one will work best, but other times a different approach is called for. One important factor in the first of the disputes about Westinghouse's contracts

⁹⁵ *Ibid* 461.

⁹⁶ *Ibid* 462.

⁹⁷ See *Florida Power and Light Co v Westinghouse Electric Co* 597 F. Supp. 1456 (E.D. Va. 1984).

⁹⁸ Judge Merhige's opinion resolving Westinghouse's liability was reversed in *Florida Power and Light Co v Westinghouse Electric Corp*, 826 F.2d 239 (4th Cir. 1987). However, because of the way the parties appealed the case, much of Judge Merhige's compromise settlement remained in place. The process served to provoke discovery of the engineering solution - reracking the cooling ponds - to the major problem in the case.

was the large number of parties who faced governmental regulation. For many reasons, no utility wanted to get a settlement that was clearly less favorable than those gained by other utilities in similar positions. Judge Merhige's control over the entire process may have coordinated matters so that no settlement would appear very much better than the others. There were only two large corporations involved in the ALCOA case, and so Judge Teitlebaum was free to issue an opinion and leave it to the parties to accept it, appeal, settle or settle after the appellate process suggested that each side had to worry about the appellate court writing an opinion that one of the parties might not like as well as Judge Teitlebaum's revised escalator clause.

Can we rely on settlement negotiations to provoke relational sanctions to all contracts problems? Clearly not.⁹⁹ As Galanter and Cahill note:

Settlement is not intrinsically good or bad, anymore than adjudication is good or bad. Settlements do not share any generic traits that commend us to avoid them *per se* or to promote them. This does not mean that some settlements are not preferable to some adjudications - and to other settlements... [T]here is, we would suppose, great variation in the quality of settlements from one disputing arena to another and within such arenas.¹⁰⁰

Often efforts at settlement cannot begin until the summary judgment hurdle has been cleared. American conditions and culture allow one party before summary judgment motions have been decided to run up the costs of litigation in order to discourage the other. Settlement should be easier when both parties are wealthy, so that one party will not have an incentive to try to induce the other to quit the litigation because of continuing court costs.

Sometimes litigation is a pure salvage operation. The parties are not interested in continuing their relationship. Settlement then becomes a question of costs and benefits. By settling, the parties reduce or eliminate uncertainty and contain costs. Things are in their control rather than in the control of judges and jurors. It may make more sense to litigate and take one's chances that any judgment recovered could be satisfied. Having conceded this, still we cannot forget that settlements also can produce compromises that keep relationships alive. The effort to settle can force the parties to cooperate and seek common interests.

We should notice how similar this coercive mediation approach is to what takes place in bankruptcy in the United States. To a great extent, in bankruptcy the parties are pushed to accept some sort of compromise to remedy the debtor's inability to perform many contracts. We get little predictability if we move from contract to bankruptcy, and the original contract controls then only if one party took a secured interest in the right form and recorded it. Those who write about contracts often fail to consider this remedy - bankruptcy - for multiple breaches of contract. Yet the most formal approach to relational contracts will have limited impact if firms facing difficulty often use bankruptcy. Any theory about the role of contract law must include the functions of bankruptcy or it will be seriously incomplete.

⁹⁹ Consumer protection almost certainly requires a different approach. It is my impression that the United Kingdom is well ahead of all but a few American states. See S. Bright, 'Winning the Battle Against Unfair Contract Terms' (2000) 20 *Legal Studies* 331; M. Dean, 'Unfair Contract Terms: The European Approach' (1993) 56 *Modern Law Review* 581 (1993).

¹⁰⁰ M. Galanter and M. Cahill, "'Most Cases Settle': Judicial Promotion and Regulation of Settlements' (1994) 46 *Stanford Law Review* 1339, 1388.

Dean Scott clearly recognises that most cases are settled, but he argues that clear rules will provoke more settlements. He argues that categorical binary contract rules may be effective complements to the more flexible extra legal mechanisms that regulate adjustment of ongoing relationships.¹⁰¹ My colleague William Whitford has offered several propositions about relational contracts.¹⁰² Whitford says:

- As contracts become more relational, the parties will comply less frequently with formalities (including the parol evidence rule). Hence, a strict enforcement strategy with respect to formalities is more likely to raise issues about protection of reasonable reliance with respect to relational than discrete contracts.

- As contracts become more relational, it becomes more difficult for courts to apply sensibly doctrine that requires courts to make qualitative judgments about a course of conduct. Courts lack the capacity to understand complex relations between all the affected parties.

- As contracts become more relational, there is an increasing tendency of the parties to value non-material aspects of the relation (continuation of the relation, maintenance of harmony and respect, etc.). Courts have no effective way to protect these expectations, and hence they tend to over commodify the relation—that is, they try to compensate in money for that which is really not commensurable this way.

What do Whitford's hypotheses mean for settlement? Dean Scott suggests that legally imposed adjustments may create perverse incentives that undermine the stability of the cooperative equilibrium of contracting parties.¹⁰³ When stakes are large, the chance that a court may rework the distribution of risk in a contract may be enough to offset possible future rewards for cooperative behavior. Even the threat of going to court to seek relief may affect how the parties readjust matters. Scott concedes that we do not know how judicial activity affects decisions about cooperation and readjustment. He concludes:

[T]he relational context is a complex environment of many regulatory systems, including individualised and patterned responses, legal and social norms, and ex ante and ex post bargains. The challenge for contract law is to construct a legal apparatus that complements these forces. As a first step, we must abandon the assumptions of legal centrism and acknowledge our incomplete understanding of contractual relationships and of the linkages between legal rules and social norms.¹⁰⁴

Scott will be right in some cases. If courts seek to impose relational contract norms in a legal proceeding, as Macneil stresses, this may not produce good faith and cooperation. The very fact that the parties have shifted from the vocabulary of contractual partners to adversaries in litigation may undercut trust and reciprocal obligations. Furthermore, one side may see incentives to gamble that it will win big in litigation. Scott certainly is right that those who think about contract law must abandon assumptions about legal-centrism and think about linkages between legal rules, social norms and the urge that many who are sued have to fight back.

Nonetheless, sometimes legal uncertainty could be a factor provoking parties to spend more effort seeking a settlement. Litigation usually is expensive and

101 R. E. Scott, 'Conflict and Cooperation in Long-Term Contracts' (1987) 75 *California Law Review* 2005.

102 W. C. Whitford, Unpublished Memorandum.

103 Scott, n 98 above, 2051.

104 *Ibid* 2053–2054.

unpleasant. Business people must turn over a large measure of control to lawyers, and many resist this. Even the threat of having a lawyer for the other side take a deposition, might be enough to deter some business people from taking the legal route; few business people would enjoy being cross examined at trial. My judgment is that in all but unusual situations, flexible doctrine will provoke settlements. The only way to determine how the doctrine applies to the particular facts of the case would be to litigate until some courts provides an answer. While lawyers may be able to predict what courts will do, they cannot guarantee that their clients will win. Even if they win, lawyers cannot guarantee that the legal rules dealing with contracts damages and an inability to satisfy a judgment will not leave a plaintiff with but a Pyrrhic victory. Settlements are under the control of business people and their lawyers. Unless money is no object and there is a point of principle, rational business people will salvage what they can by settlement and avoid throwing good money after bad in the litigation game.

Moreover, as we have seen in the *ALCOA* and *Westinghouse* cases, litigation can produce settlements. A judge, such as Judge Teitlebaum, who rewrites a contract based on his own view of what is demanded by relational norms may provoke the parties to rededicate their efforts to find a compromise that is more compatible with their needs. A judge, such as Judge Merhige, who participates actively in settlement negotiations may be able to act as a mediator backed up by his power as a judge to discipline lawyers and even the parties.

Conclusion

Clearly, contract documents often fail to capture the real deal between the parties. There are many arguments rationalising treating documents in such situations *as if* they were the complete expressions of the contracts made by the bargainers. This may avoid giving courts discretion so that we reduce the risk of arbitrary action by judges. This may even reduce the risk of decisions based on bribery. This may avoid sending courts on missions that often they cannot carry out because of the very real capability problem. Taking this approach to writings may cut the costs of goods and services so that we may have computers, airplanes, compact disks, machine tools and microwave ovens at lower prices. In some, but not all, situations these arguments have merit. Nonetheless, all of them assume that it is worth running the real risk of defeating actual reasonable expectations of bargainers in the service of some more important end.

We might at least focus the issues if we were to accept that there is a text between the lines in most contracts, and if we do not attempt to implement this implicit text, we are denying reasonable expectations. If we are willing to take an *as if* approach, we then must ask whether reputational sanctions are enough to support most ongoing transactions. Sometimes a formal approach that treats a contract as if it were a discrete transaction may be justified, but we must be sure that we consider all the costs of this approach. We might decide that there is a high cost in legitimacy if the legal system comes to symbolise that contract rests on manipulations of forms and courts reject the substance of the real deal of the parties. At the very least, if our courts allow those who draft written contracts to impose terms inconsistent with expectations and the implicit dimensions of contract, we can expect reformers to demand that the law police those bits of private legislation that masquerade as contracts so that they are fair.