Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts

Claire Hill
University of Minnesota Law School, hillx445@umn.edu

Follow this and additional works at: https://scholarship.law.umn.edu/faculty_articles

Part of the Law Commons

Recommended Citation

This Article is brought to you for free and open access by the University of Minnesota Law School. It has been accepted for inclusion in the Faculty Scholarship collection by an authorized administrator of the Scholarship Repository. For more information, please contact lenzx009@umn.edu.
BARGAINING IN THE SHADOW OF THE LAWSUIT:
A SOCIAL NORMS THEORY OF INCOMPLETE CONTRACTS

BY CLAIRE A. HILL*

ABSTRACT

Complex business contracts are notoriously difficult to write and read. Certainly, when litigation arises, courts scarcely have an easy time interpreting them. Indeed, contracts don't look at all as though they are written to tell a court what the parties want. Why can't smart, well-motivated lawyers do a better job? My article argues that they rationally do not try. I argue for a view of contracting in which parties are not principally trying to set forth an agreement for a court to enforce. Rather, by leaving inartful language and ambiguity in the agreement, parties are bonding themselves not to seek precipitous recourse to litigation. The agreement entered into provides each party with grounds to bring a lawsuit if it so desires. Thus, if one party sues, the other party will virtually always have grounds to countersue. The complex transacting community has a norm against litigation in any event; bonding encourages and bolsters this norm, as well as norms of appropriate conduct throughout the contracting relationship. The contracting process, and the contract that results, thus serves importantly to create the parties' relationship and to set the stage for dispute resolution consistent with preserving the relationship, as well as to keep available the backstop of enforcement if needed.

"When our corporate group drafts a contract, we're twice blessed."

Litigator, prominent N.Y. law firm.1

---

*Professor and Director, Institute for Law and Rationality, University of Minnesota Law School. Thanks to Lisa Bernstein, Albert Choi, Jacob Corré, Giuseppe Dari-Mattiacci, Steven Davidoff, Mary Eaton, Allan Erbsen, Dan Gifford, Tom Hill, Brett McDonnell, Bill McGeveran, Erin O'Hara, Francesco Parisi, Dan Schwarcz, Larry Solan, and participants at the American Law and Economics Association conference for helpful comments and conversations.

1As my colleague Brett McDonnell points out, this statement might be read to dispute rather than further my thesis. In my reading, the lawyer meant that the low quality of his corporate partners' drafting assured significant legal expense if the contract were to be litigated. The lawyer was not speaking to the likelihood that the contract would be litigated. Professor McDonnell notes that the lawyer might have been saying not just that the litigation was apt to be quite expensive given the unclear drafting, but also that the unclear drafting, caused by the corporate lawyers'
I. INTRODUCTION

Voluminous literature considers what the law governing contracts should be, and how the applicable legal regime will affect the behavior of contracting parties. What gap-filling and default rules should courts use? What rules would a majority of contracting parties prefer? When should rules be designed to motivate parties to contract around them? To what extent should courts use parol evidence, and for what purposes? Under what circumstances, if any, should custom, trade, course of performance, or course of dealing override the parties' written agreement? What is the proper scope of implied terms such as "good faith," "fair dealing," and "reasonable efforts"? What interpretive conventions should courts use?

I argue here that in the context of complex business contracting—mergers, joint ventures, financing arrangements, leasing arrangements, license agreements, and so on between sophisticated parties—the answers to these questions may not matter nearly as much as is typically supposed.\(^2\) Parties bargain in the shadow of the lawsuit as much as the law: that enforcement will be costly and uncertain affects how, and how much, they bargain. This effect swamps the effect of incremental improvements in law. Given the complexity and singularity of the subject matter at issue, and how much what parties will want depends on matters that cannot be known at the time of contracting (such as the state of their relationship when difficulties arise), articulating possible contingencies and agreeing on how to deal with them ex ante may be worse than leaving ex post flexibility.

How do parties bargain in the shadow of the lawsuit? First, they do less than they might to "complete" their contracts. All immediate issues are addressed, as are parties' (or their lawyers') "hot button" issues and other issues that become salient to one or both parties. But the form documents used for the transaction are not kept up-to-date, nor is the final product in a particular transaction cleaned up to eliminate confusing cross-references and possible ambiguities before the parties bind themselves to it (or afterwards, for that matter). While parties do ask themselves throughout the contracting process what they might have missed, the inquiry is not nearly as systematic incompetence, made litigation more likely.

\(^2\)In this regard, see Avery W. Katz, Contractual Incompleteness: A Transactional Perspective, 56 CASE W. RES. L. REV. 169, 171 (2005). Katz argues that "legal scholars should focus more on addressing the contractual decisions of private lawmakers (that is, transactional lawyers and their clients) and less on the decisions of public lawmakers (that is, courts and legislatures)." Id. See also Avery Katz, Taking Private Ordering Seriously, 144 U. PA. L. REV. 1745, 1762 (1996) (suggesting that more attention should be devoted to the substantive concerns of the private lawmakers than to the jurisdictional question of who is the best lawmaker).
as it might be. Second, parties could do more to reduce costs by more often choosing arbitration or waiving juries; they do not.

But parties are doing the best they can, given the complexity and singularity of the subject matter, and that the types of parties entering into complex business contracts will not be wholly homogeneous. The former suggests that anticipating and addressing contingencies will not be easy—certainly, for many contingencies, there will not be a choice of standard provisions helpfully interpreted by the courts. The latter suggests that notwithstanding the existence of a complex transacting community that constrains parties' behavior, there will not be sufficient community consensus as to acceptable behavior to obviate the need for protracted negotiations and a quite detailed contract. Indeed, the negotiations serve an important function other than memorializing the parties' agreement: they help each party understand whether the other, and the transaction contemplated, is suitable for their needs. I give an account of contracting in which parties are appropriately balancing costs and benefits, but both the costs and benefits are different than is commonly supposed.

In my account, in contracting, parties are not principally trying to set forth an agreement for a court to enforce. The contracting process, and the contract that results, importantly serves to create the parties' relationship and to set the stage for dispute resolution consistent with preserving the relationship, as well as to keep available the backstop of enforcement if needed. Sometimes there are economies of scope in these functions. For instance, creating the relationship involves defining what the relationship is; parties bargain to determine what they want and write it down in a document they can bind themselves to and later bring to court. But there are potential diseconomies as well. If parties seek to capture the last, costliest attempt at precision, they probably will not commensurately reduce their end game costs. Indeed, they may increase such costs. Bargaining more than the community norm may shrink the reputational penumbra otherwise created by the contract, encouraging an ethos in which whatever is not prohibited is permitted. Accommodation that might help relationship preservation may thereby be crowded out, replaced by a more literalistic and opportunistic mindset on the part of both parties.

This article proceeds as follows. In Part II, I argue that contracts don't look as though they are being written principally to show a court what the parties want. I argue as well that the contracting process does not seem sensibly designed to elicit contracts that would serve this function. Part III argues that contracts, as (imperfectly) written, and the contracting process, as (imperfectly) conducted, serve important functions. Part III also responds to various objections to my arguments. Part IV argues that the contracting process is sensibly designed to minimize parties' aggregate costs. Parties
stop the process of finalizing their contract before attempting to capture even fairly obvious increments of precision and clarity; in so doing, they are minimizing the sum of their relationship creation, preservation, and end game costs. Part V concludes.

II. THE "IMPERFECTIONS" OF CONTRACTS AND THE CONTRACTING PROCESS

A. Imperfections in General

In other work, I have made the (perhaps uncontroversial) claim that contracts are unnecessarily long and complicated, and not infrequently have "ambiguities that too readily allow for multiple interpretations." Contracts are redundant, with cumbersome, inartful, and imprecise drafting. What I have called "band-aid" fixes are often used: "anything in the foregoing to the contrary notwithstanding," or "for purposes solely of this Section Z, word A shall mean and include . . . ." Matters would be bad enough if parties "started fresh" in every transaction with a real fill-in-the-blanks form, but they do not. They start with what they call a form, but what is actually an already heavily cluttered document used in a previous deal and not "cleaned up." Add in the force of

---


2Considering the circumstances in which the contracts are drafted—late at night, by people who have had very little sleep—that band-aid solutions, rather than more global solutions, are used is not surprising. But why does contracting proceed in this way? I argue in the text that parties benefit from the contracts that result from this process, but the question warrants more of an answer. I have also discussed the contracting process in more depth in Claire A. Hill, A Comment on Language and Norms in Complex Business Contracting, 77 CHI.-KENT L. REV. 29 (2001) (arguing that when parties bind themselves to a contract, they are binding themselves as much or more to a relationship as they are to each of the specific terms of the contract); and Hill, supra note 3, at 76 (describing the functions served by the process of using documents from previous transactions as forms).

3See JAMES C. FREUND, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 500-01 (1975). Freund, a leading corporate lawyer, has his alter ego, Perry Prudent, chastise a junior lawyer for using a last draft because that draft contained concessions obtained in the negotiating process. The first drafts may be less cluttered than the later drafts, but they are scarcely uncluttered. And in any event, in my experience, the (relatively junior) contract drafter is told which deal to use as a precedent but is not directed to an early or later draft. Freund's depiction also seems idealized (or more precisely, not generalizable) when his alter ego criticizes the junior lawyer for adding unnecessary boilerplate to deal with a too-remote contingency. See also id. at 500 (Perry Prudent tells the junior attorney, Pete: "And then, in the one place you did a little thinking, Pete, it seems to me you went too far. I know it's possible that they'll repeal the Copyright Act some day, but it doesn't really rise to a level of probability sufficient to warrant three pages of provisions conditional upon that event."). In my experience, such criticisms were never made.
cumulation, not only for negotiated terms but also for so-called "boilerplate," and the result is a contract that is not nearly as clear as it could be, and that offers manifold opportunities for disputes after the fact. Some (indeed, probably many) of these opportunities could be addressed at the time of contracting. Parties could "clean up" contracts before signing them—but they do not. And, one might think, they should. The stereotype of bleary-eyed corporate lawyers negotiating late into the night is indeed true. Lawyers do not take a dispassionate day or two after the dust clears to afford their more rested selves a chance to review and correct, if necessary, what their very tired selves wrote.

And they have ample reason to fear that their more rested selves might catch something their tired selves did not. Consider the "band-aids": are people really sure that a particular "band-aid" agreed on in the middle of the night should override all else in "the foregoing" or "in Section X of this agreement"? What about even broader such provisions: "anything in this Agreement to the contrary notwithstanding"?

In this regard, consider the expert testimony of John Coates, a Harvard law professor and former partner at Wachtell Lipton, in United Rentals, Inc. v. RAM Holdings, Inc. one of the many recent cases in which a private equity firm was seeking not to buy a company it had contracted to buy:

One of the ways that the parties commonly economize on time and costs is to not attempt to review every provision of every related agreement every time a new change is made,

---


I think the fault lies with how even the most exalted law firms go about generating deal documentation:

- First, start with precedent contracts generated by a haphazard process of accretion and without recourse to any set of rules.
- Second, have the drafting done by junior associates who have learned by osmosis rather than through any structured process. One can count on them to regurgitate, on a wing and a prayer, the language of precedent contracts.
- Third, have the drafting reviewed by senior associates and partners who have never had to measure their drafting against any objective standards. Generally they're serenely confident of their superior talents and immune to suggestions that their documentation is flawed.
- Fourth, in revising contracts during the course of negotiation, shoehorn the revisions into the existing language, no matter how cumbersome the result.
- And fifth, do all this at a breakneck pace that precludes measured reflection.

Id.

7Id.

8937 A.2d 810 (Del. Ch. 2007).
particularly when documents are in the final stages of negotiation. Rather, they rely on succinct but legal terms of art to achieve what is, in essence, "editing" of the entirety of a document with minimal change. Among the terms of art customarily relied upon are phrases such as "subject to" or "notwithstanding." These phrases allow the parties to specify that one phrase or provision will take precedence over others, and thus avoid the need to attempt to synthesize every provision of every related agreement that is or may be partly or wholly in conflict with the provision in question.⁹

A blog post quoting the Coates report notes:

I find more interesting [Chancellor Chandler's] statement in [ruling on the affidavit]: Remarkably, in his report, Professor Coates appears to excuse practices that can only be described as inartful drafting as "one of the ways that the parties [to buyout negotiations] commonly economize on time and costs." Professor Coates states that the parties, in contravention of basic principles of contract interpretation and drafting, use certain phrases (e.g., "subject to" or "notwithstanding") so as to "avoid the need to attempt to synthesize every provision of every related agreement that is or may be partly or wholly in conflict with the provision in question." Not surprisingly, disputes often arise precisely because of provisions that are "partly or wholly in conflict" with each other.¹⁰

Indeed. It is, of course, absolutely true that parties at the last minute (and, really, throughout negotiations) negotiate and agree to use "notwithstanding" clauses. But Coates's testimony makes it seem as though each use progressively trumps all previous uses in some easy and uncontroversial

---


way. Certainly, when people agree on a "notwithstanding" clause, they may think (or more likely, hope) that is the case. Somebody has identified something that could look like, or is, a conflict among two provisions, or suspects that there might be such a conflict. The parties agree that they intend a particular provision to govern generally, or over the identified or suspected conflict "notwithstanding anything in Section X to the contrary" or "notwithstanding anything else in this Agreement to the contrary." But they don't usually look comprehensively and thoroughly, either during the frenzy of the negotiations or the calm that succeeds them, at the ramifications of the new "notwithstanding" clause on the rest of the agreement.

B. Examples From Private Equity

As market conditions have declined, many private equity firms have sought to not consummate acquisitions they had previously agreed to. In a reversal of a previous norm not to litigate, cases are being litigated. In the litigation, it has become clear that the parties' rights and obligations when the buyer no longer wants to make the acquisition are anything but clear. There are various types of provisions at issue: reverse termination fees, seller rights to require specific performance, material adverse change clauses, and parties' obligations to use best or reasonable efforts to obtain required approvals or financing, or otherwise work to make the transaction possible. It has become clear that, in many cases, nobody looked closely (enough) at the interaction of the provisions governing the buyer's and seller's rights and obligations regarding the consummation of the deal.


The Cerberus–United Rentals flap continues a growing litigation trend: M&A deals ending up in court after acquirers try to walk away from deals. In Sunday's New York Times, Andrew Ross Sorkin reflected on these busted deals. "Private equity firms, widely hailed as the "smart money," made some lousy deals in the second half of this year, and some are now having a bad case of buyer's remorse," he wrote. "Apparently all is fair in love, war and private equity."

Id. (quoting Andrew Ross Sorkin, If Buyout Firms Are So Smart, Why Are They So Wrong?, N.Y. TIMES, Nov. 18, 2007, at 3.8).

12Davidoff, supra note 11, at 59.
The foregoing offers some evidence for my position, and against traditional views of contracting. But a few caveats must be acknowledged: First, that in hindsight it is clear what should have been done does not mean it would have been clear ex ante; traditional views appropriately emphasize the ex ante perspective. Furthermore, the traditional views can readily accommodate one dynamic probably at issue here: imprecision left by parties to retain a litigation position, when they concluded that negotiations would have yielded a worse result, a definitive rejection of their position(s) (something also known as "leaving a strategic handle"). Finally, as to (at least) one type of provision, "material adverse change," achieving clarity may simply be exceedingly difficult: as a practical, and perhaps, theoretical, matter, defining ex ante such a change in a manner that commands assent by the parties and applies cleanly to a significant number of circumstances may be impossible. Each side, genuinely or self-servingly, knows a material adverse change when it sees it, and the two sides may see it differently. Still, reading the slew of private equity cases now being litigated, it seems likely that people did not sufficiently think through the circumstances in which the provisions at issue might be implicated. Why wouldn't they have done so? Because of the practice I discussed above and explain in the next section, to stop sooner, before "completing" the agreement.15

In this regard, consider a recent blog posting:

Finally, for those interested in topping Darden's bid, the termination fee is $39.6 million. If another bidder makes a superior proposal, then under Section 5.02(b) of the merger

---

13See United Rentals, 937 A.2d at 845 (articulating a closely related rationale: "in fact, parties often riddle their agreements with a certain amount of ambiguity in order to reach a compromise"); supra note 8 and accompanying text. This rationale is discussed infra Part III.

14For an interesting explanation of MAC (material adverse change) or MAE (material adverse effect) clauses, see Ronald J. Gilson & Alan Schwartz, Understanding MACs: Moral Hazard in Acquisitions, 21 J.L. ECON. & ORG. 330 (2005). The authors reject a "symmetry hypothesis" in favor of an "investment hypothesis"—that such a clause encourages the target to make investments that are not feasibly contractible during the period between signing of the deal and closing. Id. at 332.

15Note that in civil law countries, the parties stop contracting far sooner than they do in the United States. See generally Claire A. Hill & Christopher King, How Do German Contracts Do as Much With Fewer Words?, 79 Chi.-Kent L. Rev. 889 (2004) (discussing contracting practices in Germany). When parties stop is very much a function of convention among the relevant parties. In both the United States and in civil law countries, though, attempting to keep negotiations going beyond the traditional point at which one stops conveys a negative signal that one is not aware of or willing to do what the conventions dictate, and perhaps that one is particularly inclined towards litigation. I return to this point in the text accompanying infra note 46.
agreement, RARE cannot terminate the agreement "unless concurrently with such termination the Company pays to Parent the Termination Fee and the Expenses payable pursuant to Section 6.06(b)." The only problem? Expenses is used repeatedly throughout the Agreement as a defined term everywhere except 6.06(b)—which makes no references to Expenses or even expenses. In fact, it appears that nowhere does the agreement define Expenses. Transaction expenses can sometimes be 1-2% of additional deal value, a significant amount that any subsequent bidder must account for. So how much should a subsequent bidder budget here? Or to rephrase, what expenses must RARE pay if a higher bid emerges? And how can RARE terminate the deal to enter into an agreement with another bidder if RARE does not know which expenses it is so required to pay? Darden may also want similar certainty as to its reimbursed expenses, if any, in such a paradigm. Lots of questions in this ambiguity. Not the biggest mistake in the world, but Wachtell, attorneys for the buyer, and Alston & Bird, attorneys for the seller [both sophisticated firms, with Wachtell being one of the most prominent law firms in the US and probably the world], both have incentives to fix this one.16

Bolstering my argument, consider that the ambiguity at issue was probably in the "form" used as a basis for the documents rather than introduced in this deal: somebody writing such provisions anew would presumably also include a definition of Expenses. Most likely, the "form" was generated over time, with the portion negotiated in a particular deal being the one focused on in that deal: nobody read the whole document sufficiently thoroughly to notice the missing definition. Indeed, in my experience in practice and according to practitioners I have spoken to, particularly when mistakes in definitions are found—where the definitions do not work together, or where a term was supposed to be defined but is not—the mistakes were also in the "form" used for the transaction in which the mistake is discovered. Thus, when a mistake is found in one transaction

document, it often also exists in many transactions done using the same form.

One extreme example of a mistake from a form involves a medium-sized private company. A clause that was supposed to say "you will not compete" omitted the "not." The mistake appeared in all acquisition transactions done by the company for an appreciable period of time. When the mistake was pointed out to the lawyer who had drafted the documents and done the transactions, he shrugged, noting that his client, the party exacting the promise, had a position in the industry and vis-à-vis the would-be competitor that would virtually ensure that the latter would not find it in its interest to compete.17

Another example concerns a situation in which the parties' difficulties may not have been due to "stopping sooner," but rather, to leaving open litigation positions when full agreement would not have been possible. Still, the case is worth discussing, principally to show that the use of the term "notwithstanding" in a provision did not lead the court to view the provision as trumping other provisions specifically referenced in the provision. The case also illustrates the intricacy (to put it mildly) of the language courts are called upon to interpret, and consequently, how close the determinations at issue are. Commentators did not know how this case would come out, and offered sound reasoning for many possible positions.18 Neither this holding (nor this reasoning) nor a contrary holding (nor some alternative reasoning) could readily be labeled "error."

The case at issue is the one discussed in the previous subpart, United Rentals, Inc. v. RAM Holdings, Inc.19 RAM Holdings and RAM Acquisitions (collectively, RAM), corporations controlled by Cerberus Capital Management, L.P., a major private equity firm, were formed to acquire URI.20 URI, RAM, and, for some purposes, another affiliate of Cerberus entered into a merger agreement (Merger Agreement) governing the terms by which RAM would acquire URI.21 At some point after entry into the Merger Agreement, Cerberus (and therefore RAM) decided it did not want to

---

17Supporting material on file with The Delaware Journal of Corporate Law.
19937 A.2d 810 (Del. Ch. 2007).
20id. at 814.
21id.
acquire URI, and RAM informed URI that it would not be proceeding with the acquisition.\textsuperscript{22} RAM took the position that, under the Merger Agreement, it could terminate its obligations by paying a termination fee of $100 million.\textsuperscript{23} The Merger Agreement indeed provided that RAM could satisfy its obligations by paying such a fee.\textsuperscript{24} However, it also provided for specific performance, and URI took the position that it could require RAM to consummate the transaction and filed suit.\textsuperscript{25} The court was called upon to determine the relationship between the termination fee provision and the specific performance provision.\textsuperscript{26} The termination fee provision, section 8.2(e), had a "notwithstanding" clause:

\begin{quote}
Notwithstanding anything to the contrary in this Agreement, including with respect to Sections 7.4 and 9.10 [the specific performance provision], (i) the Company's right to terminate this Agreement in compliance with the provisions of Sections 8.1(d)(i) and (ii) and its right to receive the Parent Termination Fee pursuant to Section 8.2(c) or the guarantee thereof pursuant to the Guarantee, and (ii) [RAM Holdings]'s right to terminate this Agreement pursuant to Section 8.1(e)(i) and (ii) and its right to receive the Company Termination Fee pursuant to Section 8.2(b) shall, in each case, be the sole and exclusive remedy, including on account of punitive damages, of (in the case of clause (i)) the Company and its subsidiaries against [RAM Holdings], [RAM Acquisition], [Cerberus Partners] or any of their respective affiliates, stockholders, general partners, limited partners, members, managers, directors, officers, employees or agents (collectively "Parent Related Parties") and (in the case of clause (ii)) [RAM Holdings] and [RAM Acquisition] against the Company or its subsidiaries, affiliates, stockholders, directors, officers, employees or agents (collectively "Company Related Parties"), for any and all loss or damage suffered as a result thereof, and upon any termination specified in clause (i) or (ii) of this Section 8.2(e) and payment of the Parent Termination Fee or Company Termination Fee, as the case may be, none of [RAM Holdings],
\end{quote}

\textsuperscript{22}Id. at 827.
\textsuperscript{23}United Rentals, 937 A.2d at 819.
\textsuperscript{24}Id. at 831.
\textsuperscript{25}Id. at 831-32.
\textsuperscript{26}Id. at 836-37.
[RAM Acquisition], [Cerberus Partners] or any of their respective Parent Related Parties or the Company or any of the Company Related Parties shall have any further liability or obligation of any kind or nature relating to or arising out of this Agreement or the transactions contemplated by this Agreement as a result of such termination.\(^{27}\)

Another part of section 8.2(e) provides that:

[i]n no event, whether or not this Agreement has been terminated pursuant to any provision hereof, shall [RAM Holdings], [RAM Acquisition], [Cerberus Partners] or the Parent Related Parties, either individually or in the aggregate, be subject to any liability in excess of the Parent Termination Fee for any or all losses or damages relating to or arising out of this Agreement or the transactions contemplated by this Agreement, including breaches by [RAM Holdings] or [RAM Acquisition] of any representations, warranties, covenants or agreements contained in this Agreement, and in no event shall the Company seek equitable relief or seek to recover any money damages in excess of such amount from [RAM Holdings], [RAM Acquisition], [Cerberus Partners] or any Parent Related Party or any of their respective Representatives.\(^{28}\)

The last sentence of section 8.2(a) provides that "[t]he parties acknowledge and agree that, subject to Section 8.2(e), nothing in this Section 8.2 shall be deemed to affect their right to specific performance under Section 9.10."\(^{29}\)

URI claimed that it was entitled to specific performance under the Merger Agreement; RAM claimed that URI was not.\(^{30}\) The court concluded that there was no "single, shared understanding with respect to the availability of specific performance under the Merger Agreement."\(^{31}\) It deemed both interpretations reasonable and looked to extrinsic evidence. It ruled for RAM, on the grounds that URI did not communicate its understanding that

\(^{27}\)United Rentals, 937 A.2d at 816-17.
\(^{28}\)Id. at 817 (italics and bracketed text are in the opinion, but not the Merger Agreement as entered into by the parties).
\(^{29}\)Id.
\(^{30}\)Id. at 832.
\(^{31}\)United Rentals, 937 A.2d at 836.
specific performance was available to RAM, but RAM did communicate to URI its understanding that specific performance was not available. URI, therefore, did not meet its burden of persuasion.

Still, it is interesting to consider URI's argument that it was entitled to specific performance, an argument deemed reasonable by the court. URI accounted for the language providing that section 8.2(e) governs, and the language in section 8.2(e) describing itself as the "sole and exclusive" remedy against RAM when there has been a termination of the Merger Agreement by either party, as follows: URI argued that the "sole and exclusive" remedy is only such when there has been a termination of the Merger Agreement as defined under the RAM-URI agreement, and there had been no such termination. URI also argued that the phrase "in excess of" in the phrase prohibiting equitable remedies or money damages in excess of the termination fee in section 8.2(e) applied only to equitable remedies that involve monetary compensation—that what the phrase prohibits, in the realm of equitable remedies, is such remedies in excess of the termination fee. URI also argued that the phrase in section 8.2(a) referring to specific performance, albeit making it subject to section 8.2(e), showed the availability of specific performance as a remedy, not eliminated notwithstanding the parties' clear awareness of it. The court rejected RAM's arguments that URI's construction was unreasonable, pointing to the language in section 9.10 acknowledging that irreparable damage would occur if the provisions in the RAM-URI agreement were not performed, and that URI would be entitled to an injunction to enforce compliance. "Given this clarion language supporting the existence and availability of specific performance, it is reasonable to read the limitations of section 8.2(e) in the manner that URI has championed.

While deliberately ambiguous phraseology may have contributed to the court's task, so too, importantly, did the general convention of drafting using these kinds of clauses and cross-references. Surely, even the provisions in this contract not involving any strategic ambiguity left by one or both parties could have been far clearer.

---

32 Id. at 836.
33 Id.
34 Id. at 831-32.
35 United Rentals, 937 A.2d at 831-33.
36 Id. at 830-32.
37 Id. at 832.
38 Id.
III. AN EXPLANATION FOR CONTRACTING'S "IMPERFECTIONS": HOW THE SPECTER OF COSTLY AND UNCERTAIN LITIGATION BENEFITS THE PARTIES

Why don't parties (or, more precisely, their lawyers) clean up their contracts after the fact? Smart and sophisticated parties can clearly do better, and with some much-needed sleep, they would. Indeed, it is likely that some lawyers (especially junior ones) think, the day after a deal closes: "if I could only go back and fix this" (or, "I have no idea what is in that document"). It strains credulity to conclude that contracts as finalized represent the best that smart, highly motivated, and well-paid lawyers can do to make their clients' rights and duties clear to a court.

But nobody takes seriously "cleaning up" a contract after hard-won negotiations. Why not? A few familiar reasons suggest themselves. In revising to clarify terms or preclude inconsistencies, new areas of disagreement might emerge between the clients (perhaps in situations where the hands-on individuals involved might be blamed by their seniors), or a lawyer may discover something she missed. Or one side may reassess a decision made during the negotiations to leave a strategic handle—that is, to stay silent and thereby leave open a litigation position. If the agreement's terms are revisited, the transaction could fall apart. Thus, parties may reasonably decide that signing less-than-clear documentation is their best choice. In this regard, Richard Posner argues that "[d]eliberate ambiguity may be a necessary condition of making the contract; the parties may be unable to agree on certain points yet be content to take their chances on being able to resolve them, with or without judicial intervention, should the need arise."

Posner goes on to claim that: "[p]arties . . . . may rationally decide not to provide for a contingency, preferring to economize on negotiation costs by delegating completion of the contract to the courts should the contingency

---

39See supra note 4. It is beyond the scope of this article to consider why the process has people negotiating and drafting, including, most importantly, as the agreement is being finalized, when they need sleep.

40Some additional evidence supporting this argument—that contracts importantly serve functions other than specifying the parties' rights and obligations to a court—is that contracts contain provisions that parties know are unenforceable (such as "party X's obligation is enforceable notwithstanding the party's bankruptcy") or that parties know are largely useless as grounds for contract damages (such as a contractual obligation to notify the other party if one's insurance coverage ceases to be in effect). This point is discussed in Hill, supra note 4, at 52-53 (describing other provisions importantly serving functions other than specifying the parties' rights and obligations to a court).

materialize. This is especially likely if they think there is only a slight probability that the contingency will materialize.\footnote{42}

In my view, the "strategic handles" argument—that parties may conclude that unclear language allowing for a litigation position may be preferable to attempts to raise and resolve the issue directly—does indeed explain some failure to complete contracts. Consider the RAM-URI case discussed above. The argument accords as well with my experience as a corporate lawyer. Agency costs may also play a role. Corporate lawyers may want to avoid the embarrassment of seeing what nonsense got into the agreement during the frenzy of the negotiations, as may agents (of the clients) who did the hands-on negotiating on behalf of their principals. The lawyer and client-agents can discourage revisiting the contract by suggesting that doing so might endanger hard-won agreements.

I am far less persuaded that parties to complex business contracts stop sooner because they are saving themselves time and money, relying on courts to fill their gaps or construe their ambiguous language. Real-life negotiations certainly do not feel as if any expense is being spared. To the contrary, no loose end or open point that anyone identifies as such is left undiscussed or unresolved. Moreover, junior lawyers responsible for the day-to-day drafting and negotiating (but not responsible for when the deal is considered "done") are given a message very much to the contrary: if a contingency, no matter how remote, occurs that you did not provide for, or if some language you wrote turns out to give the other side a good argument, your professional advancement will suffer. Finally, if the money-saving explanation was correct, we might expect that the more likely contingencies would be those addressed in complex business contracts.\footnote{43} To the contrary,

\footnote{42}Id. In a roughly similar vein to Posner's first argument quoted in the text, George Geis argues that:

indefinite contracts are sometimes created because an imprecise term—combined with judicial willingness to fill gaps—can generate an embedded option. In other words, each party may think that the deal can be performed, at a minimum, by complying with the vague term in a manner favorable to the other side. But there is also a chance that one side will be able to secure his preferred interpretation of the vague term through persuasion or litigation—especially under the current trend toward a loose indefiniteness doctrine and greater judicial gap filling. This possibility can be viewed as an embedded option, which the party may seek to exercise if future uncertainties play out in a particular way.


\footnote{43}Given that the "forms" used for contracts already contain unlikely contingencies, the money-saving explanation might have some validity if the set of contingencies dealt with in each successive agreement were the likeliest set. I think that even that limited claim isn't tenable, notwithstanding the example to the contrary in supra note 5. Lawyers in my experience wouldn't
the set of contingencies we see addressed do not seem to correspond linearly to the set of more likely contingencies.\textsuperscript{44} Remote contingencies are often addressed; what seem like more likely contingencies are left unaddressed.\textsuperscript{45} Still, some of the traditional explanations—a combination of leaving strategic handles, agency costs on account of lawyers and agents of the clients wanting to conceal mistakes from their principals, and nobody wanting to find areas of disagreement that might endanger a hard-won willingness to consummate a deal—are clearly an important part of the story.

But none of this explains why law firms do not try harder to have "clean" contracts, regularly updated, that they require their lawyers to use. While in terrorem incentives do indeed make junior lawyers fear missing something and throw enormous energy at not doing so, why make their jobs harder? The task is challenging in any event—even the smartest and most energetic lawyer may miss something, and this is particularly true for a junior lawyer. Why not take advantage of the resources the firm has available to do the best it can in this regard—the time and reflection of smart and experienced people who are not in extremis? Moreover, lawyers have incentives to not be seen as obstructionist deal hinderers—these incentives can dilute the in terrorem incentives. Clients, and their agents, can also blame the lawyers for not having caught something that later becomes an

\textsuperscript{44}This point is discussed in Hill, \textit{supra} note 3, at 72-73 (providing an explanation based on path-dependence as to which contingencies are addressed and which are not). Of course, "most likely contingencies" means those appropriately considered as such ex ante.

\textsuperscript{45}Consider in this regard \textit{In re Walt Disney Co. Derivative Litig.}, 906 A.2d. 27 (Del. 2006). Ovitz became president of Disney. After an unsuccessful one-year tenure, he was terminated, not for cause, and given $130 million in severance pay. \textit{Id.} at 35. Various court opinions in the case noted that the compensation consultant who worked with the board to design the compensation package had not fully computed how much Ovitz would be entitled to if he were terminated other than for cause. \textit{See, e.g., In re Walt Disney Co. Derivative Litig.}, 907 A.2d 693, 770 (Del. Ch. 2005). It is generally known that "for cause" terminations are rare, because the standard is so high—serious misbehavior is required. Thus, it was likely that any termination would be not for cause. The parties presumably intended that one possible not for cause termination would yield a significant payout: that Ovitz's skills at his previous job simply weren't the skills needed for the Disney job. \textit{In re Walt Disney Co.}, 906 A.2d at 43. Indeed, an important reason the severance package was large was that the two jobs were quite different. \textit{Id.} at 36-37. But, importantly, it was also known that both Eisner and Ovitz had strong (even difficult) personalities. \textit{Id.} While it may have been expressly contemplated that Ovitz would be paid for the risk that his talents wouldn't serve him as well at Disney as they had at his previous job, what actually happened—that Ovitz's employment was quickly determined not to work out in circumstances falling short of a for-cause termination but apparently reflecting less than best efforts by Ovitz (and a personality clash with Eisner) was arguably sufficiently likely, even ex ante, that it should have been addressed to prevent a $130 million payout in such circumstances.
issue, giving the firm additional incentive to try to prevent as many mistakes as it can. A ready process exists to minimize the possibility that contract documents are missing something or include a "mistake"—that law firms keep up-to-date forms that get rid of murky drafting, ambiguous cross-references, problems with definitions, and the like. Why is it not being used?

The foregoing strongly suggests that parties are not doing what they can to make their contracts clear to a court. The lack of clarity has an expected cost: the murkier the contract, the higher the possible litigation expenses (one would think), and the wider the settlement range, making settlement less likely than it otherwise might be. The murkier the contract, the more likely it is that what was supposedly agreed upon will turn out to be amenable to disagreement ex post. The murkier the contract, the likelier it is that by reviewing it ex post, in the context of a possible or actual lawsuit, a party can construe provisions or omissions in a manner adverse to the other party, regardless of what the parties intended. So, parties are apparently subjecting themselves to unnecessary uncertainty and cost by stopping the contracting process when they do. They work hard throughout the process, poring over each word endlessly, and at a certain point—not when they are satisfied that all glitches have been caught, but rather, when they have "sufficiently agreed"—they pronounce themselves done and sign the papers.

This is puzzling. At least as puzzling, and perhaps more puzzling, is why parties are apparently not taking advantage of another way to reduce costs and perhaps uncertainty: arbitration. Arbitration is surely cheaper, if

---

46 That litigation, and particularly, pretrial procedure, is exceedingly costly, is a commonplace observation. Some commentators observe that a subset of cases is disproportionately responsible for the costliness; this is the very subset at issue in this article, involving high-stakes cases and large law firms. See, e.g., Interim Report of the Committee on Civility of the Seventh Federal Judicial Circuit, 143 F.R.D. 371, 395 (N.D. Ill. 1992). In this regard, consider, too, that one important impetus to the Private Securities Litigation Reform Act (PSLRA), Pub. L. No. 104-67, 109 Stat. 737 (codified in scattered sections of 15 U.S.C.), was to stop plaintiffs from being able to go on "fishing expeditions." The lawsuits at issue were characterized as "have price drop will sue"; one of the provisions of the PSLRA was that plaintiffs needed more than conclusory allegations to be able to subject the defendant to typical (and onerous) discovery requests. See also Griffin Terry, A Critical Analysis of the Formulation and Content of the 1993 Amendments to the Federal Rules of Civil Procedure, 63 U. Clin. L. Rev. 869, 869 (1995) (noting that 1993 amendments were in response, in part, to "excessive cost and delay inherent in . . . litigation"); Martha Neil, Litigation Too Costly, E-Discovery a "Morass," Trial Lawyers Say, ABA J., Sept. 9, 2008, http://www.abajournal.com/news/litigation-too-costly_e-discovery_a-morass_trial-lawyers_say (discussing the excessive costs associated with discovery).

47 Indeed, it is interesting to consider why pretrial procedure cannot be made less costly or onerous. For instance, why do parties (or lawyers) not develop reputations for conducting only nonstrategic discovery? It is hard to answer such a question definitively, but the process may be noisy enough, and may be unpredictable enough, that it will be very hard to establish in a manner
not more certain. But a recent article by Ted Eisenberg and Geoffrey Miller, "The Flight From Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies," found "[l]ittle evidence . . . to support the proposition that these [large, sophisticated] parties routinely regard arbitration clauses as efficient or otherwise desirable contract terms. The vast majority of contracts did not require arbitration; only about 11% of the contracts did.

What about other ways of reducing costs and uncertainty? One way might be to waive a jury. But Eisenberg and Miller find that there are very few jury waivers in large commercial contracts. They argue that "our results suggest that juries can add value to complex commercial adjudication." I offer another explanation—for the "stopping sooner" contracting practice I have discussed, for failure to choose arbitration, as well as for the failure to waive juries: *the uncertainty and costs of litigation serve as a bond the parties give against precipitous recourse to litigation, aligning the parties' incentives to resolve any disputes without formal resort to the court system.* Returning for a moment to the failure of parties to waive juries, juries might increase the uncertainty, and perhaps the costs, of litigation and hence increase the size of the bond.

How do these bonds work? Again, they increase the expected cost of litigation for each party: each party knows that should it commence litigation, the other party will be able to impose significant costs. And some of these bonds also arguably increase uncertainty. The outcome of a trial involving a murky contract, or one involving a jury verdict, should be more uncertain than one involving a clearer contract or a verdict rendered by a judge. Thus, giving this bond discourages litigation.

Discouraging litigation serves another important function: it binds together, and helps craft and hone norms for, the complex transacting
community in which transacting parties operate. These norms encompass the end game, but also entry into relationships and relationship preservation. Law may be limited in the extent to which it can influence conduct. Even if contracts were clearer, the uncertainty and cost of legal process would be substantial, not to speak of the length of time involved in pursuing a lawsuit. The uncertainty may be nearly intractable. Many of the agreements are highly and individually negotiated; it is therefore unlikely that precedent exists to guide interpretation of many of the provisions that might be the subject of litigation. Even those that are not so highly and individually negotiated, such as "cookie-cutter" agreements (that is, multiple agreements using the same basic model, as are used for financings done in series, such as many leveraged leases and mortgage-backed securities) nevertheless have not generated much precedent. And even if a contested provision itself was previously interpreted, the fact situations are sufficiently complex that they are hard to stylize into precedent that could be readily and easily applied in a subsequent dispute in which that provision was at issue. Contrast the types of provisions at issue, and the types of arguments that could be made with respect to breaches, with their corollaries in contracts for simple commodities, in which there is, for instance, a requirement to deliver commodity X, of Y quality, on Z day. One approach contracts use to supply flexibility is the use of standard-like terms such as "materiality" and "reasonableness" and "best efforts." But litigation of these provisions has been, to be polite, a mess. Community consensus may very well be better at establishing what is meant when these terms are used and punishing breaches of the associated duties (and norms), as well as establishing and enforcing more generally what counts as acceptable (and unacceptable) conduct in the course of a contractual relationship. The dynamic is path-dependent, and self-reinforcing. Once the norms for negotiating and contracting are established, seeking additional increments of precision may signal one's propensity to litigate, which may in turn signal that one is a less desirable transacting

\[53\] Indeed, I have elsewhere contrasted complex business contracts with simple contracts for commodities. As to the latter, Professor Lisa Bernstein has argued that parties effectively make two contracts: one, the end game contract, that literally means what it says—ten business days is ten business days—and the other, the contract during the relationship, in which the parties' agreement is actually the terms agreed upon as modified by norms of the industry and of their relationship. See Lisa Bernstein, Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms, 144 U. Pa. L. REV. 1765, 1798 (1996). As to the former, I argue that there are infinite numbers of contracts. The contract as written scarcely has one determinate meaning, and importantly serves to set the stage for (re?)negotiation when the transaction is not going as one or both parties intended; moreover, the parties' "contract" when they are getting along may be better established with reference to their relationship than to the physical document laying unconsulted in someone's drawer. See Hill, supra note 4, at 54 n.57, 57.
partner. Asking for the kind of review I have said people do not ask for, after the negotiations have ended but before the documents are signed, may indicate distrust of the other party as well.

It is critical to note, however, that the reputational community I have described has, and needs, legal enforcement as a backstop. The bond that the parties give—the bond that constrains them from litigating—can not, should not, and will not, be "too" large. The contract has to have some appreciable amount of detail and cannot just leave everything to the relationship; the results of litigation can not be "too" indeterminate. If a party is truly an "outlaw," as a practical matter not sufficiently amenable to legal process, the mechanism will not work as it needs to.54 Consider in this regard the well-known corporate law case, Credit Lyonnais Bank Nederland, N.V. v. Pathe Communications Corp.,55 involving Credit Lyonnais's attempts to enforce a corporate governance agreement for MGM against the bank's borrower, the entity to which it had lent money to acquire MGM.56 The borrower never repaid one cent of its significant borrowings, in excess of $1 billion dollars.57 Credit Lyonnais did not call a default when it initially was entitled to, agreeing instead to acquire significant control over the management of MGM (and other rights), as specified in the form of a corporate governance agreement, should the borrower not honor its obligations to the bank.58 The borrower did not honor its obligations, making increasingly specious arguments about forgeries, lack of authority, and so on, as well as actually manufacturing forged documents, making physical threats against the bankers, and the like.59 It managed to avoid significant penalties for some time; the individual most responsible fled to Italy and was pursued by authorities in many jurisdictions. The bank suffered serious losses, requiring it to be bailed out by the French authorities; it also suffered considerable embarrassment.60 The title of an article by David McClintick in


56Id. at *1, reprinted in 17 DEL. J. CORP. L. at 1103-04.

57Id. at *5, reprinted in 17 DEL. J. CORP. L. at 1110.

58Id. at *7, *9, reprinted in 17 DEL. J. CORP. L. at 1113, 1116-17.


60The defendants attempted to reopen the judgment. Credit Lyonnais Bank Nederland, N.V. v. Pathe Commc'ns Corp., No. 12,150, 1996 WL 757274 (Del. Ch. Dec. 20, 1996), reprinted in 22 DEL. J. CORP. L. 1186 (1997). In its opinion, the court noted:

It appears that, after the trial of this case, the events giving rise to it have been the subject of a number of criminal and civil actions in several different jurisdictions,
Fortune magazine says it all: "The Predator: How an Italian Thug Looted MGM, Brought Credit Lyonnais to its Knees, and Made the Pope Cry."\(^{61}\)

As this example suggests, the system does best when parties rely on extra-legal forces for increments for which it is well suited: to deal with interactions among somewhat heterogeneous parties in a larger transactional community,\(^{62}\) where some basic commonalities of principles and values can be presumed, but it is considered fair game to take advantage to "some degree." Norms arise as to how the community will regard some types of behavior that might fall within the realm of taking advantage: as to, for instance, whether waiting to make each payment until the end of the applicable grace period is acceptable, or whether, when a payment is late, calling a default is acceptable even if the lateness does not adversely affect the recipient. Where basic commonalities cannot be assumed, extra-legal forces are less effectual, and recourse to law is far quicker; contracts written with parties with bad reputations cost more to negotiate and draft precisely because of the greater expectation that such parties will exploit every

\(^{61}\) David McClintick, The Predator: How an Italian Thug Looted MGM, Brought Credit Lyonnais to its Knees, and Made the Pope Cry, FORTUNE, July 8, 1996, at 128.

\(^{62}\) If the parties are sufficiently homogeneous, extra legal forces may do more in supplanting legal forces, and may leave less room for "acceptable" amounts of strategic behavior. See Hill & King, supra note 15.
possible loophole in the contract, something that is less of a concern with parties with better reputations. We can expect that Giancarlo Paretti's next transacting partner, if he can find one, will require gold-plated assurances, in the form of promises from, or access to monies of, reputable third parties.

Two important objections can be made to my argument thus far. First, given litigation costs and uncertainty, why is an additional bond, in the form of increased costs and uncertainty, needed? Second, how can keeping a contract murky be a bonding device to limit litigation when it may increase a party's available causes of action and possible payoff?

My answer to these objections requires an account of how the bond I have hypothesized works, and the contexts in which litigation might arise. I make a few assumptions; from my practice experience and my discussions with practitioners, I believe that these assumptions are widely held and uncontroversial. First, I assume that there is a general relationship-preserving norm in the complex business community against bringing litigation except if there has been a serious attempt to resolve the dispute or an extraordinary circumstance of some sort. Second, I assume that a party's threshold ability to sue is importantly not linearly related to what the parties intended and addressed in the contract. There are indeed "clear breaches." However, many circumstances that yield losses can be argued to be breaches; a party who looks hard enough to find a plausible argument to bring a suit against the other party will most likely succeed. This is so for a clear or a murky contract, although it is, of course, more so for the murky contract. But it is not feasible to make a contract clear enough to foreclose suit for anything other than clear breaches: where there is a strong enough will to bring suit, there is a way.

If a party wishes to preserve its reputation, reputational costs of violating the no-quick-recourse-to-litigation norm will weigh significantly on how it chooses to proceed. An additional bond, over and above those costs and the well recognized costs and uncertainty of litigation, is probably not necessary to discourage litigation in the normal course; if the loss is extraordinary, especially if there is a clear breach, the party may choose to litigate, and, in such circumstances, there may be no reputational cost. That being said, if there is a clear breach, the other side should find it worthwhile to settle. And this should be so regardless of whether there is a clear or murky contract or, indeed, regardless of whether the party is in relationship-preserving mode or not (unless it is in end game with respect to the community as a whole).

Now, consider a party willing to incur the reputational costs of litigation, especially where the loss motivating it to sue is not associated with a clear breach. Perhaps the party is facing losses that could put it in end game. Perhaps the party wishes to acquire a reputation for being litigious.
Perhaps, in an agency cost dynamic, the person or people making the decision to litigate have some personal antipathy towards the other company or its CEO. While "in the long run" agents of this sort should not survive, the short and moderate term can last quite a while. A CEO might have enough other good qualities that a propensity to litigate precipitously might not disqualify her from a position as a CEO. Indeed, the very traits that might lead to too-ready recourse to litigation, such as decisiveness, aggressiveness, and independence, might be quite valuable in other contexts. Where reputation is not a bar, litigation might seem cheap enough that it would be worthwhile. And a party that was not in relationship-preservation mode might "play dirty," trying to impose costs on the other side as much as, if not more than, pursuing the case on the merits.

The increment my theory addresses is the one between a murky contract and a clearer one, where reputation does not constrain a party from suing and, particularly, where what motivates it to sue is not a clear breach under the contract. What the murky contract does is lower the costs for the party being sued (call it Party 2) to countersue. Once it is sued by a party not in relationship-preservation mode (here, Party 1), relevant norms will permit a largely commensurate counterattack (and perhaps even a more-than-commensurate counterattack). The increment of extra costliness and uncertainty brought about by a murky contract—the weapons Party 2 now has available—should serve to dissuade all but the most determined Party 1-type parties. But giving Party 2 this weapon comes at the cost of increasing the size of Party 1's expected payoff—it, too, has more grounds to sue and more probably of prevailing in a suit—hence, it might seem, giving Party 1 more impetus to sue. This is a fair theoretical objection to my argument. However, as a practical matter, this effect is swamped by the size of the weapon given to Party 2. Once a party no longer constrained by reputation has weapons to use against Party 1, it could use them. Party 1's cost-benefit computation should, therefore, be far less likely to favor a suit, especially for a murky breach.

IV. COST MINIMIZATION MORE BROADLY

A. How Does Contracting Minimize Parties' Costs?

The foregoing has implications for a broader understanding of contracts and the contracting process. Uncontroversially, parties contract until the cost of further contracting exceeds the benefits. One way of articulating parties' costs and benefits is to distinguish between several types of costs: the classically articulated end game costs (including the probability that the parties will enter into end game), relationship maintenance costs, and
another type of cost—the cost of establishing and specifying the terms of the parties' relationship. The literature as to the latter type of cost focuses more on a subset of this type of costs: specification costs.\(^6\) However, establishing and specifying the parties' relationship is a different, and broader, endeavor, as I discuss below.\(^6\)

The contracting process I have described minimizes the sum of specification costs and end game costs; it probably has a neutral effect on relationship maintenance costs, except insofar as the relationship as established during the specification stage was such as to warrant greater or less wariness and vigilance. Consider, for instance, the typical example of providing for remote contingencies. The consensus view is probably that it reduces end game costs but increases relationship establishment and specification costs. On my account, the analysis is more complex. The increase in relationship, establishment, and specification costs is considerable. But end game costs may not decline much, or even at all; they may even increase.\(^6\)

As I argued earlier, except at the extremes, the parties' ability to impose costs on each other in litigation is often not closely correlated with the merits of their position regarding the dispute at issue. Indeed, the merits may not be determinable within a broad range, nor do the parties think they would be. Moreover, if parties negotiate such contingencies beyond what is standard in the community, they may crowd out some of the community's relationship-preserving norms, making litigation (and general cost increasing wariness) more likely.

Relationship establishment and specification costs encompass both the traditional elements and some less traditional ones. They include the costs of parties coming to feel comfortable with one another—to determine that they want a relationship, in the first instance—as well as the more typically considered costs of addressing all immediate issues (for example, how much the immediate payment is, and how it is to be made) and each party's "hot button" issues.


\(^6\)See Hill, supra note 3, at 70-71 (discussing cost minimization in contracting).

\(^6\)In this regard, I do not think less effort spent on drafting appreciably increases error costs in the range at issue. Consider the URI/Cerberus decision. See supra text accompanying notes 19-38. I argued that the language being interpreted was sufficiently complex that commentators were divided as to how the court would rule, and many offered reasoned and sound arguments for their positions. See supra text accompanying note 20. Indeed, the concept of "judicial error" in this context scarcely seems to capture the reality: a choice of one among alternative plausible interpretations of some tortured opaque language.
Information is given and conveyed through the contracting process. The process can be direct; however, it is also often indirect, "a messy communicative act." Simply interacting over a protracted period of time reveals a great deal: What sort of people does the other side hire? Are they easygoing or irritable? How confident are they about their recordkeeping? How do they react when they are asked a question about their existing contracts or the lawsuits against them? How much authority have they given their negotiator may say something about what sorts of hierarchies the firm has. The customs and conventions of the transacting community always serve as a backdrop. The information revealed when the U.S. lawyer presents her one hundred page long first draft to the other side (in the United States) is quite different than the information revealed when the German lawyer presents the identical draft to the other side in Germany. Norms and conventions develop as to when to stop, what to cover, what contractual fixes to use, what increments of precision to leave unaddressed, and at what stage the parties consider themselves done and ready to legally bind themselves through contracting formalities. Parties stop when the costs of continuing exceed the benefits. The costs include not only those of articulating additional increments of precision, but also those of violating norms as to when the process should stop, as well as those relating to the antilitigation bond being given.

As has been extensively discussed in the literature, norms and conventions also develop to govern the parties' relationship when they are getting along. But I have argued that there are also conventions and norms, critically, as to when litigation is acceptable and what tactics are acceptable in litigation in particular circumstances. Interestingly, and consistent with the view of litigation costs as a potential bond, what comes to be seen as fair game in litigation itself, especially a suit brought in response to a murky breach, includes arguments that are quite "a reach"—not rising to the level of frivolous under Rule 11, but certainly quite aggressive, and tactics in the discovery process that are quite aggressive as well.

Contrast my view with that of Richard Posner. Discussing minimizing the transaction costs of contracting, Posner argues that:

66Douglas A. Kysar, The Expectations of Consumers, 103 COLUM. L. REV. 1700, 1757 (2003). Kysar uses the term to describe purchasing decisions by consumers. Id. His use is analogous to mine: one is directly doing X (asking a question, buying a product), but in doing so, one is doing many things that are equally important (conveying one's vigilance, perhaps, in the case of a question about pending lawsuits, or conveying one's civic mindedness, in the case of buying a product made in an environmentally friendly way).

67Hill & King, supra note 15, at 897.

68FED. R. CIV. P. 11.
When a dispute over the contract's meaning arises, the parties will first try to resolve it themselves. They will do this not only because of the costs of litigation, but also because of the reputation factor that I discussed earlier: the party demonstrably in the wrong on the interpretive issue will hesitate to force the issue to litigation; he is likely to lose and in any event may acquire a reputation as someone who does not honor his commitments. The more carefully drafted the contract is, the easier it will be for the parties to resolve a dispute over its meaning when the dispute first arises, in other words at the prelitigation stage. 69

Posner thinks carefully drafted contracts reduce the parties' costs; as to some increments of care, I have argued to the contrary. Clearly, careful drafting costs more than careless drafting; Posner thinks the more-than-commensurate benefits result in less litigation because the party "demonstrably" in the wrong's expected value computation will push the party to settle or concede. Posner would be right if the set of disputes likely to arise was largely coextensive with the set of disputes where one party is demonstrably in the wrong and especially, if more careful drafting made the two sets more nearly coextensive. But, as I have argued, a loss that does not reflect a clear breach may nevertheless tempt a party to bring a lawsuit. In some such cases, the other party may have the better argument, but the party incurring the loss will not be "demonstrably wrong." Reputational costs (and straightforward monetary costs) should generally deter a party from bringing a lawsuit if it is "demonstrably in the wrong." I think, however, that even if parties expended more effort in their contract drafting, losses tempting a party to sue will often not be associated with a clear breach in which one party is "demonstrably in the wrong." Reputation will deter many suits, even if only on account of the antilitigation norm I have discussed. Monetary considerations, and perhaps reputation, will limit suits where a party clearly will lose. But a large set of potential suits remain.

Posner also argues that the probability of litigation is lower as the costs of negotiating and writing the contract increase: "[T]he more time the parties spend negotiating and drafting the contract, the lower the probability that a dispute over meaning will arise, because more of the possible contingencies will be covered by explicit contractual language." 70 Again, I

69 Posner, supra note 41, at 1614.
70 ld. at 1608.
I disagree with Posner. I do not think the relationship between negotiation and drafting costs and probability of dispute is at all linear. Whether a dispute arises depends largely on whether one or both parties becomes unhappy in the relationship, which often turns on the world changing in the way the parties did not expressly anticipate, and in a manner that they did not, and could not, have comprehensively and satisfactorily provided for before the fact. More effort put towards drafting within any reasonable range is not likely to ameliorate the problem commensurate with the added cost.

B. Evidence from Private Equity

I have argued thus far that the relevant relational and reputational community has a norm against precipitous recourse to litigation; parties bond themselves by entering into contracts that are less clearly written than they easily might be. But of course, when the stakes get high enough, parties enter end game and resort to litigation. This is precisely what has occurred in the context of private equity acquisitions, where there are many lawsuits involving purchasers, sellers, and the financial institutions that were to finance the purchases. The dynamic is self-perpetuating. The losses are, by definition, significant and, as more suits are brought, whatever reputational constraints there might have been are lessened or eliminated.

In this regard, see a recent blog posting:

Wachovia's Lawsuit Against Providence Equity:

Providence Equity Partners, a private equity firm, signed a deal to purchase television stations from Clear Channel. Wachovia agreed to finance the $500m deal. Providence and Clear Channel agreed to a reduced purchase price because the stations revenues were down. Now Wachovia wants out, arguing the price reduction is not enough and that the deal should be canceled. Wachovia is arguing that the price reduction itself is a material adverse change, triggering the MAC [(Material Adverse Change)] condition in the deal agreement and, incorporated by reference, a similar MAC condition in the financing arrangement. This case is odd because Wachovia must convince a judge that a reduction in price (and thus in the financing commitment) is an "adverse" change. The case is representative [sic] of the new kind of "hardball'[sic] being played in the buyout financing markets.
Reputation (for honoring one's word) be damned; save the ship.\(^7\)

Interestingly, the plaintiff's argument, at least as explained in the blog, scarcely seems persuasive. This should not be surprising. As I discussed above, if a party to a complex business contract wants to impose costs on the other by pursuing litigation, it can almost always do so. Plaintiffs will manage to find some legal argument; even if the argument could not prevail at trial, it will nevertheless enable costly discovery, interrogatories, and filing of motions.

V. CONCLUSION

In the picture of complex business contracting I have presented here, law plays a nuanced and limited role. "Good enough" contracts and "good enough" law work together to encourage the development of a reputational community in which appropriate norms can develop and be enforced. These norms allow for and promote flexibility consistent with relationship preservation. They proscribe behavior the community deems unacceptable, even if the behavior at issue can neither be specified ex ante nor verified ex post. They also favor relationship preservation over precipitous recourse to litigation, with parties bonding themselves thereto by potentially subjecting themselves to costly and uncertain enforcement.

What follows from these arguments? First, my account helps explain several puzzling phenomena. Why are contracts not written more clearly, with fewer confusing cross-references ("anything in the foregoing to the contrary notwithstanding")? Why do parties not opt out, in whole or in part, more often than they do, from formal legal process, for instance by providing that their disputes will be resolved via arbitration? Why do parties not waive juries more often than they do? My answer is that costly and uncertain enforcement serves as a bond; increasing precision in a contract beyond a certain point does not provide a benefit that exceeds its cost and indeed, may even be a cost.

Second, my account suggests a way to view various doctrines that push parties towards specification of their agreements but do not absolutely prohibit less-than-fully-specified agreements. These doctrines encourage the development of a reputational community to take up the slack, and complement parties' incentives to develop reputations and maintain them within that community. Consider in this regard courts' claims "that they do not make contracts for the parties"\textsuperscript{72} in the face of doctrines by which gap-fillers, default provisions, and interpretive rules can be used to do precisely that.\textsuperscript{73} The parol evidence rule, too, is amenable to a similar analysis.\textsuperscript{74}

Third, my account provides an argument for dethroning rhetoric and doctrine that emphasizes the parties' subjective intentions.\textsuperscript{75} In many of the cases at issue, there may not be a subjective intention. A search for objective "intention" may be more appropriate, if only to economize on court time and effort, so long as it does not appear that one party was strategic in leaving the door open for a subsequent dispute. A similar rationale may also favor majoritarian rather than information-forcing defaults in such circumstances. Fourth, my account may support an argument that sophisticated parties are better off with somewhat indeterminate law.

Finally, my argument also suggests a different perspective on the well-worn subject of "incomplete contracts." It is well known that parties do not write contracts that tell the court what they want in each possible state of the

\textsuperscript{72} Rulli v. Fan Co., 683 N.E.2d 337, 339 (Ohio 1997) (citing 1 ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 4.1 (rev. ed. 1993)).

\textsuperscript{73} See Walker v. Keith, 382 S.W.2d 198, 204 (Ky. 1964) (stating that "courts should not expend their powers to establish contract rights which the parties, with an opportunity to do so, have failed to define").

\textsuperscript{74} What about the effect of the parol evidence rule on litigation costs? Interestingly, some litigators have told me that even if the jurisdiction governing their case is Willistonian, they nevertheless seek in discovery evidence the court conceivably might exclude. Given that most cases do not proceed to trial, and the vast bulk of litigation expenses and time are spent in discovery, even in Willistonian jurisdictions the parol evidence rule may therefore not serve as much of a constraint.

\textsuperscript{75} Contract interpretation is canonically directed towards determining parties' subjective intent. For a thoughtful discussion, see Lawrence M. Solan, Contract as Agreement, 83 NOTRE DAME L. REV. 353 (2007). Solan contrasts the subjective approach used for interpretation to the ostensibly objective approach used for contract formation:

At the same time as courts profess to commit themselves to an objective approach in their analysis of contract formation, they repeat as a constant refrain in cases involving the interpretation of contracts that their one concern is to discover the intent of the parties, and reach a decision that will vindicate that intent. They say it so often that it cannot be explained by an occasional reversion to a nineteenth century-like slip of the tongue.

\textit{Id.} at 388. Professor Solan goes on to suggest that "objective" talk might be better explained as either that the objective fact pointed to is good evidence of subjective intent, or that the promisee's reasonable and subjective belief should estop the promisor, whatever the promisor's actual intent.
world; I argue here that they rationally do not try as hard as they could, notwithstanding contrary indications in the rhetoric and trappings of the contracting process. My account suggests a way to describe what parties might (or might not) find it worthwhile to complete in incomplete contracts. It also sheds light on the dynamics of the contracting community, showing how law can interact with norms, path dependence, institutional dynamics, and agency costs to produce the kinds of contracts we see. My ultimate conclusion, though, may be this: the now-established recognition of the importance of extralegal forces in contracting needs to be better integrated into the scholarship of contracting; the analysis of statutory law and court-made law needs to take into account the limited and intricate role of law in parties' contracting behavior.