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SOCIAL NORMS AND DEFAULT RULES ANALYSIS

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This comment explores how the insights of relational contract theory can be integrated into the analytic framework of default rules analysis (DRA). It rejects Jay Feinman’s contention that using a “relational approach . . . would [necessarily] ask different questions,”¹ and argues that social norms and other aspects of the contracting context that are of central importance to relational theory are directly relevant to the questions and concerns² that are at the heart of two of the leading academic approaches to DRA:³ the consent theory articulated by Barnett⁴ and the economic approach developed by Ayres and

* Associate Professor, Boston University School of Law. I would like to thank Ian Ayres, Randy Barnett, Edward Bernstein, Robert Bone, Joseph Brodley, Daniel Klerman, Robert Merges, Mark Petit, Matthew Spitzer, Manuel Utset and Todd Rakoff.


2. This comment does not take issue with Richard Craswell’s observation that relational scholars and law-and-economics scholars tend to be interested in different questions. See Richard Craswell, The Relational Move: Some Questions from Law and Economics, 3 S. CAL. INTERDISC. L.J. 91, 91 (1993). Rather, it argues that many aspects of contracting relationships that are of interest to relational scholars, are, in many transactional settings, directly relevant to the questions and concerns that are of interest to law-and-economics scholars.

3. This comment discusses DRA solely in the context of a negotiated business transaction. But see infra note 78. Although the DRA literature sometimes focuses on corporate law and products liability, many of the issues discussed in this comment would be analyzed differently in these contexts. In many areas of corporate governance, collective action problems prevent shareholders from bargaining with management. Similarly, in the products liability context, one party to the transaction tends to have vastly inferior information, and collective action problems effectively prevent meaningful negotiation. Consequently, the justifications for using a hypothetical bargain approach to gap filling in these contexts may be stronger than they are in the context of a negotiated business transaction. See, e.g., Frank H. Easterbrook & Daniel R. Fischel, Corporate Control Transactions, 91 YALE L.J. 698, 702 (1982) (suggesting that the fiduciary duty that managers owe investors should reflect the hypothetical bargain that managers and investors would have struck had they been able to costlessly negotiate with one another free of collective action problems); Alan Schwartz, Proposals for Products Liability Reform: A Theoretical Synthesis, 97 YALE L.J. 353, 361 (1988) (suggesting that products liability legislation should be modeled on the hypothetical contract that fully informed consumers would bargain for if they could do so costlessly).

Gertner.\textsuperscript{5}

This comment argues that recognizing the centrality of social norms in many transactional settings and acknowledging that not all transactions are “discrete” and that not all transactors appear to act as “steely-eyed utility maximizers,” neither fundamentally undermines DRA nor justifies adoption of Feinman’s “relational alternative.” It concludes that when the analytic frameworks developed in the DRA literature are modified to take relational factors into account, it is possible to gain new insights into the default rules debate.

This comment also suggests that current judicial, legislative and academic approaches to DRA need to take into account the implications of the widespread availability of private alternative dispute resolution (ADR). It demonstrates that adapting the consent theory and the economic theory of DRA to take into account the availability of ADR alters their conclusions in ways that must be recognized if they are to provide useful guidance to courts and legislatures in deciding how best to deal with contractual gaps.

Part I discusses the role of social norms in legislative and judicial approaches to gap filling and describes the consent theory and economic theory of DRA. It then explores the extent to which these approaches to DRA take relational factors into account and concludes that while the consent theory explicitly incorporates many of the factors relational theorists consider important, the economic theory needs to be modified if it is to adequately take into account the differences between “discrete” and “continuing” exchange and the influence of relational factors on parties’ drafting decisions.

Part II considers how giving more explicit recognition to social norms and other relational factors might alter the analysis and conclusions of DRA. It suggests that in highly relational exchanges, the "relational discount" on the benefit of contracting around legal default rules may be so large, and the "relational costs" of doing so may be so high, that parties may not contract around even those legal default rules they find highly undesirable.

Part III discusses Feinman's "relational alternative," which would fill contractual gaps using "norms, insights, arguments, and rules of thumb." It argues that filling gaps with subjective relational standards may decrease access to justice for poorer, more risk-averse litigants, and may, depending on the content of such standards, limit contracting opportunities for certain types of transactors.

Finally, Part IV considers the implications for both DRA and Feinman's "relational alternative" of the widespread availability of ADR. It concludes that legal default rules should be structured to give parties an incentive to opt out of the legal system in situations where their doing so would be socially desirable.

I. THE ROLE OF SOCIAL NORMS AND RELATIONAL FACTORS IN DRA

One of Feinman's strongest objections to DRA is that "[s]ocial norms are powerful motivators of behavior, yet DRA has no place for them." However, he fails to recognize the extent to which social norms and other relational factors are already incorporated into existing legal and academic approaches to gap filling and DRA. One of the underlying goals of the Uniform Commercial Code is "to permit the continued expansion of commercial practices through custom, usage and agreement of the parties"; the code explicitly permits contracts to be "explained or supplemented . . . by course of dealing or usage of trade."
In addition, courts often seek to resolve linguistic ambiguities and fill contractual gaps by reconstructing the parties’ hypothetical bargain, asking the question, “[W]hat would the parties have agreed to had they explicitly adverted to the issue?” Although some courts answer this question in a relatively objective and formalistic manner, others engage in a broad-ranging factual inquiry that explicitly takes into account social norms and other aspects of the contracting context that relational theorists consider important. On a doctrinal level, the hypothetical bargain approach provides no guidance on how particularized and contextualized the court’s inquiry should be. As a consequence, it is consistent with giving social norms and institutions

establish a contract.”). In addition, just as the “idea of balancing party planning against maintaining flexibility as relations develop,” is a central tenet of relational contract theory, see Feinman, supra note 1, at 56, the Official Comment to U.C.C. § 1-102 notes that “[t]his Act is drawn to provide flexibility so that . . . it will provide its own machinery for expansion of commercial practices.”

12. David Charny, Hypothetical Bargains: The Normative Structure of Contract Interpretation, 89 Mich. L. Rev. 1815, 1815 (1991) (exploring and critiquing the hypothetical bargain approach to gap filling and contractual interpretation); see also Katz v. Oak Indus., Inc., 508 A.2d 873, 880 (Del. Ch. 1986) (explaining that in deciding whether a particular action constitutes breach of the implied covenant of good faith, the court should ask: “[I]t is clear from what was expressly agreed upon that the parties who negotiated the express terms of the contract would have agreed to proscribe the act later complained of as a breach of the implied covenant of good faith—had they thought to negotiate with respect to that matter.”); Wisconsin Real Estate Inv. Trust v. Weinstein, 781 F.2d 589, 593 (7th Cir. 1986) (Easterbrook, J.) (“[W]hen supplying terms of an effective but incomplete contract a court properly picks those for which the parties probably would have bargained, had they anticipated the problem.”).


14. Id. at 1856-57 (suggesting that in reconstructing hypothetical bargains courts use custom in three ways: “First, to determine what transactors intend by using a term, courts may advert to how transactors ordinarily use that term. . . . Second, courts consult trade custom to infer meaning from how parties conduct themselves. . . . Third, courts may infer meaning from parties’ conduct in reference to particular language.”).

15. Id. at 1821 (suggesting four approaches to reconstructing hypothetical bargains: “choose the best rule for this transaction type,” “choose the rule that these particular parties most likely would have negotiated,” “choose the rule that the parties in this situation would have chosen if they were rational and perfectly informed,” and “choose the rule that parties to this transaction type would most likely choose in the general run of situations”). However, while a court using the hypothetical bargain approach might make a detailed inquiry into relational aspects of the contracting context, the purpose of the inquiry would be to determine what the parties would have agreed to at the time of contracting. In contrast, a court using the relational approach would also focus on events that occurred both before and after contract formation, since the relational “paradigm indicates the continuity of the contracting event with other elements of relational context, both preceding and following the formal contract.” Feinman, supra note 1, at 54.
the greater prominence relational scholars consider appropriate.\footnote{But see Feinman, supra note 1, at 54 (noting that "it is incorrect to attempt to determine the content of default rules based on what the parties would have wanted [(the hypothetical bargain)], because that approach overemphasizes and idealizes the discrete act of contracting.").}

Feinman also fails to appreciate that while neither the consent theory nor the economic theory gives relational factors the prominence they deserve, relational factors are, to some extent, explicitly taken into account in the consent theory, and are relevant to many of the considerations the economic theory identifies as being central to parties' drafting decisions.

A. **Consent Theory**

Barnett's theory of conventionalist default rules is based on his consent theory of contract;\footnote{For a detailed articulation of the consent theory of contract, see Randy E. Barnett, A Consent Theory of Contract, 86 COLUM. L. REV. 269 (1986).} it endeavors to give the greatest weight possible to parties' subjective manifestations of assent. According to Barnett, "where a consent to jurisdiction exists but is insufficient to justify the enforcement of any promulgated set of default rules, consent justifies the enforcement of conventionalist default rules."\footnote{Barnett, supra note 4, at 829.} These rules are given content by "seek[ing] the most plausible interpretation of the conduct of the parties within the relevant community of discourse," that is, "the general community of which both parties are members or, where the parties are merchants, their particular trade."\footnote{Id. at 862 & n.90.} This approach can be highly contextualized. As Barnett explains, "if it can be shown that the parties are highly idiosyncratic and have in essence their own 'private language,' then the 'community of discourse' consists solely of them."\footnote{Id. at 862 n.90.}

Although Barnett does not specify the precise factual inquiry needed to determine the content of conventionalist defaults, it would most likely encompass many of the factors important to the relational approach, which "focuses attention on certain features of relationships and localizes the rules and decisions in particular relationships and classes of relationships."\footnote{Feinman, supra note 1, at 54.} Barnett considers his consent theory of
contract a relational theory; comparing it to Ian Macneil’s relational approach, Barnett suggests that “what separates Macneil’s relational theory of contract from a consent theory may not be that one is relational and the other is not, but rather that a consent theory is a relational approach that is decidedly liberal whereas Macneil’s is a relational approach that is communitarian.”

Barnett is also sensitive to the questions of baseline and perspective that are at the core of Feinman’s critique of DRA. As Feinman explains, the DRA “paradigm suggests the completeness of the parties’ contracting, with occasional gaps filled by default rules,” whereas from a relational perspective it is impossible to know if a contractual gap exists without recognizing the broader relational context in which the contract was made. Similarly, Barnett acknowledges the indeterminacy of labeling a given contractual silence a gap, noting that “the legal system usually cannot know whether it is facing a situation of true gaps or tacit assumptions.

B. THE ECONOMIC THEORY

Ayres and Gertner’s economic theory of default rules explores the ways that the content of default rules can be used to create incentives for parties to draft the largest possible number of efficient contracts. It compares the incentive effects and efficiency implications of hypothetical bargain defaults, which fill gaps with what the parties would have wanted, and penalty defaults, which are “purposefully set at what the parties would not want” in order to “give at least one party to the contract an incentive to contract around the default rule . . . ”

relevant to contract adjudication, they have fundamentally different views of the purpose of contract adjudication. Barnett views the central task of contract adjudication as discerning the parties’ intent and giving legal effect only to those rights and obligations the parties consented to create. See Barnett, supra note 4. In contrast, Feinman views the central task of contract adjudication as imposing desirable social values on contracting parties. See Feinman, supra note 1, at 56.

22. Feinman views Macneil as a like-minded relational scholar. See Feinman, supra note 1, at 45 n.4.


24. Feinman, supra note 1, at 53-54.


26. See generally Ayres & Gertner I, supra note 5.

27. Id. at 91.
The economic theory suggests that when contractual gaps are due to the transaction costs of negotiating and drafting specific provisions, hypothetical bargain defaults are appropriate when it is less expensive for the court to reconstruct the parties' hypothetical bargain ex post than it would be for the parties to negotiate an explicit contractual provision ex ante. In contrast, when the cost to the court of filling a gap ex post is greater than the cost to the parties of including a specific provision ex ante, a penalty default is appropriate since it will decrease parties' incentives to "inefficiently shift the process of gap filling to ex post court determination." In addition, when contractual gaps are due to strategic behavior—such as a party's reluctance to propose a provision that might reveal information that would lead to a price adjustment—penalty defaults will ordinarily be preferred to hypothetical bargain defaults since they will "induce knowledgeable parties to reveal information by contracting around the default penalty."  

Although Ayres and Gertner do not explicitly discuss the influence of relational factors on parties' decisions to accept or contract around default rules, as discussed in Part II, social norms and relational factors affect many of the considerations that the economic theory identifies as being central to the parties' drafting decisions, such as the transaction costs of negotiating and drafting specific provisions, the probability of breach, and the distribution of information between the parties. In addition, the importance of taking relational factors into account when choosing between hypothetical bargain and penalty defaults becomes apparent once it is recognized that in order for Ayres and Gertner's framework to lead to efficient contracting it needs to be modified in two ways. First, rather than comparing the cost to the parties of drafting a provision ex ante to the cost to the court of filling the gap ex post, the cost to the parties of drafting the provision ex ante should be compared to the expected cost to the court of filling the gap ex post—the cost discounted by the likelihood that a dispute related to the provision will arise and actually go to

28. Id. at 93.
29. Id.
30. See id. at 101-04 (discussing the reasons why parties are often reluctant to suggest contracting around the rule of Hadley v. Baxendale, 156 Eng. Rep. 145 (Ex. 1854)).
31. Id. at 94.
32. For example, in many situations the distribution of information between the parties will depend on incidents of their status, the market in which they are transacting, and the size of their business.
trial. Second, in determining the type of contracting behavior it is socially desirable to encourage, it is also important to consider the fact that the parties themselves may fill the gap at the time the contingency arises. In highly relational exchanges where parties view cooperation as being in their own best interest, the expected cost to the parties of negotiating a gap-filling term at the time the contingency arises may be less than the cost to the parties of including a specific provision ex ante or the expected cost to the court of filling a gap ex post. As a consequence, in certain transactional contexts, the socially desirable default rule might be one that encouraged the parties to fill the gap cooperatively at the time the contingency arose, and minimized the transaction costs of their doing so.

In sum, because relational considerations affect the expected cost to the parties of filling the gap when a contingency arises, the cost to the parties of including a specific provision ex ante, and the expected cost to the court of filling the gap ex post, they need to be taken into account in determining the types of contracting behavior it is socially desirable.

33. It is important to note that even setting aside relational considerations, the probability of breach (or, the probability of a particular contingency arising) needs to be taken into account in the economic approach.

34. There are a number of reasons why at the time of contracting the expected cost to the parties of filling a gap if a contingency arises might be lower than both the expected cost to the court of filling the gap ex post and the cost to the parties of including a specific contractual provision ex ante. First, even if the cost of drafting a specific provision is the same as the cost of negotiating a term at the time the contingency arises, the costs of negotiating a term at the time the contingency arises will only be incurred if the contingency actually arises, whereas the cost of drafting the provision will be incurred with certainty. Second, it is often easier to deal with a contingency when the actual consequences of its happening are known with certainty. Third, the value of the relationship to both parties might increase during the course of performance. If, at the time the contingency arises, the parties attach a greater value to achieving a cooperative outcome than they did at the time of contracting, the actual cost of negotiating a gap-filling term may be lower than the cost of negotiating a specific provision would have been at the time the contract was entered into. For example, in a buyer-supplier situation, after a period of performance, the buyer might be impressed by the quality of the supplier's products, his willingness to make production adjustments in response to changes in the buyer's specifications, and in his ability to meet production deadlines. Similarly, the supplier might be impressed by the buyer's record of prompt payment, his willingness to pay small price increases when production adjustments are requested, or his willingness to accept substitute materials when substitutions are warranted by market conditions. Once both sides attach a higher value to the relationship and have incurred relationship-specific sunk costs, they have a greater incentive to cooperate than they did at the time the contract was entered into and other trading partners were available. Thus, the expected cost of negotiating an additional term if the contingency occurs during the course of performance might be lower than the cost to the parties of negotiating and specifying the term ex ante or the expected cost to the court of filling the gap ex post. Furthermore, there may be additional benefits to deferring consideration of some contingencies such as avoiding relational costs, reducing the risk of transaction breakdown, and increasing the likelihood of concluding the transaction by the relevant deadline.
desirable to encourage and the types of default rules that are most likely to induce such behavior.

C. Summary

Thus, although the consent theory explicitly takes some relational factors into account, and relational factors will affect many of the considerations the economic theory identifies as being central to parties' drafting decisions, neither theory adequately takes into account the myriad of ways that social norms and other relational factors influence parties' negotiating and drafting decisions throughout the contracting process. However, explicitly incorporating relational factors into these approaches to DRA would not, as Feinman maintains, undermine their analytic structure by demonstrating that "neither [their] assumptions nor [their] conclusions are sound." Rather, as the analysis presented in Part II demonstrates, distinguishing between "discrete" and "relational" exchanges and giving more explicit recognition to the ways that relational factors influence parties' drafting decisions, enriches the analysis of the academic approaches to DRA and demonstrates the power of their analytic structures.

II. Incorporating Relational Factors into DRA

The strength of social norms and institutions in a given transactional context affects whether transactors will find it worthwhile to use legally enforceable contracts; it also affects the likelihood that they will choose to vary legal default rules. In many transactional settings, promises are kept for reasons wholly unrelated to the existence of a legally enforceable contract. Parties may be induced to perform or voluntarily compensate the promisee in the event of nonperformance out of fear of nonlegal sanctions such as reputational damage. Or,

35. Feinman, supra note 1, at 54.
36. The existence of a legally enforceable contract may, in some contexts, strengthen the force and effect of social norms and extralegal sanctions by serving the channeling, evidentiary and cautionary functions of formality. See Lon L. Fuller, Consideration and Form, 41 COLUM. L. REV. 799, 800-01 (1941). In order for some extralegal sanctions such as damage to reputation to have a significant effect on parties' behavior, third parties must be able to verify that an agreement existed and a breach occurred. Consequently, if a party is found by a court to have breached a contract, he may suffer greater damage to his reputation than he would if he had merely breached an extralegal agreement. In addition, the fact that a judgment has been rendered against him sends a signal that he not only failed to meet his commercial obligations, but also failed to cooperatively resolve a dispute with his trading partner.
37. For an overview of nonlegal sanctions, see David Charny, Nonlegal Sanctions in Commercial Relationships, 104 HARV. L. REV. 373, 392-94 (1990) (discussing the three main types of
as Feinman suggests, they may be moved to do so by social custom or a "concern for relationships, trust, honor, and decency." In transactional contexts where social norms or fear of nonlegal sanctions result

nonlegal sanctions that play a role in commercial transactions, namely "the sacrifice of a relationship-specific prospective advantage," "loss of reputation among market participants," and "the sacrifice of psychic and social goods" (emphasis omitted)).

38. Feinman, supra note 1, at 52. Feinman rejects the notion that these concerns "can be explained away by elaborate calculations of interest," id., and maintains that "social norms cannot be reduced to optimizing mechanisms in disguise." Id. at 53. However, a growing body of empirical research on social norms suggests that in many markets or transactional contexts, social norms, nonlegal sanctions and extralegal dispute resolution institutions tend to be efficient from the perspective of market insiders. See, e.g., Oliver E. Williamson, Calculativeness, Trust, and Economic Organization, 36 J.L. Econ. 453 (1993) (drawing on a variety of examples to demonstrate that behavior social scientists refer to as trusting or non-calculative can often be explained as calculative when viewed in a wider social context); Robert C. Ellickson, ORDER WITHOUT LAW: How Neighbors Settle Disputes 167 (1991) (using evidence from a number of case studies to support the hypothesis that "members of a close-knit group develop and maintain norms whose content serves to maximize the aggregate welfare that members obtain in their work-a-day affairs with one another."); Robert C. Ellickson, A Hypothesis of Wealth-Maximizing Norms: Evidence from the Whaling Industry, 5 J.L. Econ. & Org. 83, 84 (1989) (using evidence from the early-American whaling industry to provide support for the "hypothesis that when people are situated in a close-knit group, they will tend to develop for the ordinary run of problems norms that are wealth-maximizing."); Lisa Bernstein, Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry, 21 J. Legal Stud. 115 (1992) (concluding that the diamond industry's transactional rules and private dispute resolution institutions have endured since they are an efficient way to structure exchanges and resolve disputes). As a consequence, in markets or transactional contexts with well-developed social norms, even transactors who make no individual calculations of self-interest, but choose instead to act in accordance with such well-developed norms, may make the same decisions as a "steely-eyed utility maximizer." Social norms may already embody a cost-benefit analysis. See, e.g., Henri Lepage, TOMORROW, CAPITALISM (Sheilagh C. Ogilvie trans., 1978) (arguing that "customs and tradition survive because... they offer more benefits than costs"). For an overview of the economic and philosophical literature exploring the idea that social norms tend to be efficient, see John Gray, HAYEK ON LIBERTY (2d ed. 1986).

In arguing against the validity of the "assumptions of rationality and self-interest," Feinman points to the fact that "[i]n commercial behavior involving transactions of all types, parties often fail to bargain to the last dollar. [They]... talk of obtaining a good price or a fair price, but not necessarily the best price. ..." See Feinman, supra note 1, at 52. However, the developing literature in game theory and law has begun to demonstrate that what relational scholars call cooperative or altruistic behavior is often a rational utility-maximizing strategy, especially in the types of long-term repeat-dealing situations that are of central concern to relational contract theorists. See, e.g., Scott, supra note 5 (arguing that "[c]ontracting parties agree (explicitly or implicitly) to cooperate in the future, not because of altruism, but because it lowers the ex ante contract price by more than the cost of cooperation"); Gillette, supra note 5, at 540 (explaining that "a party may bargain for cooperation in the belief that mutual promises to coordinate are likely to produce higher personal payoffs than threats of defection from the relationship"); see also Robert Sudd, THE ECONOMICS OF RIGHTS, CO-OPERATION AND WELFARE (1986) (exploring the ways that strategies with a high degree of cooperation can maximize joint payoffs in many simple games, including the repeat-play prisoners' dilemma). For an additional explanation of why it is often rational for even "self-interested social isolates" not to bargain to the last dollar, see infra note 44 and accompanying text.

Feinman also maintains that the methodology employed by law-and-economics scholars is
in a high probability that promises will be performed or that adequate damages will be voluntarily tendered in the event of nonperformance, the value added by placing the agreement in legally enforceable form may be small—a legally enforceable agreement only creates value to the extent that it gives the parties something they would not have had if the transaction had been concluded with a handshake.

Relational factors will also have a strong influence on parties' perceptions of the benefits of contracting around legal default rules. Consider the following example. Suppose that two “self-interested social isolates” who intend to rely solely on their legal rights in the event of a dispute are deciding whether or not to include a provision dealing with a given contingency. The provision costs $5.00 to draft and will create an additional $10.00 of value if the contingency occurs.

flawed and their conclusions invalid since “it takes remarkable modesty for scholars to assume that ordinary people can intuitively arrive at the analysis that yields optimal results, when scholars can do so only after much sophisticated training and work,” particularly when such people often lack complete information. Feinman, supra note 1, at 52. However, economists and game theorists have developed ways to model decision making in situations characterized by uncertainty and asymmetric information. See, e.g., HOWARD RAIFFA, DECISION ANALYSIS: INTRODUCTORY LECTURES ON CHOICES UNDER UNCERTAINTY (1968) (discussing “how an individual who is faced with a problem of choice under uncertainty should go about choosing a course of action that is consistent with his personal basic judgments and preferences”). In addition, a growing body of research has begun to explore the ways that market forces may, under certain conditions, help ensure that parties with incomplete information enter into the same contractual arrangements that would be selected by fully informed parties. See, e.g., Alan Schwartz & Louis L. Wilde, Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis, 127 U. PA. L. Rev. 630 (1979) (suggesting that in deciding whether legal intervention in consumer markets is appropriate, “rather than asking whether an idealized individual is sufficiently informed to maximize his own utility, the appropriate normative inquiry is whether competition among firms for particular groups of searchers is, in any given market, sufficient to generate optimal prices and terms for all consumers.”)

At this juncture it is important to note that whether or not parties' decisions to value attributes of their relationship, such as trust and good will, are rational or not is of no consequence to the argument made in the text. The importance of parties' views of the relational cost, see infra text accompanying notes 40-45, of suggesting that certain default rules be varied, does not depend on the reasons, rational or not, that parties choose to value those aspects of their relationship that might be jeopardized by suggesting that too many default rules be altered by specific contractual provisions.

39. Although the signaling effects discussed in the text may be particularly strong in a relational context, they are present to some extent in all commercial transactions. Because litigation is expensive and expectation damages never fully compensate the promisee, all contracts are backed, at least in part, by a reputation bond. Just as the use of legally enforceable contracts can increase the value of extralegal sanctions, the threat of extralegal sanctions in a given transactional context can increase the value of a legally enforceable promise by increasing both the probability of performance and the probability that compensation will be voluntarily tendered in the event of nonperformance.

40. Although it is assumed for simplicity that the probability of the contingency happening is not affected by relational factors, the likelihood of many types of contingencies, such as breach
and the court applies the provision rather than the relevant legal default rule. In this situation, the parties will compare the cost of including the provision, here $5.00, to the expected benefit of including it—($10.00) \times (\text{the probability that the contingency will occur}) \times (\text{the probability that if the contingency occurs, the court will be asked to resolve the dispute, here 100%})—and will only include it if the expected benefit of doing so is greater than the cost. The self-interested social isolates will therefore include the clause only if the probability of the contingency occurring is greater than 50%. Now suppose that two parties with strong relational ties are considering including the same provision. In the event that the contingency occurs, these parties may be reluctant to go to court and quite likely to work out a cooperative agreement on how to deal with the contingency. If these parties view the likelihood that they will be unable to reach a cooperative agreement in the event that the contingency occurs as 25%, and the probability that the contingency will occur as 60%, unlike the “self-interested social isolates,” they will not opt to include the provision since the expected benefit to them of doing so, $1.50—($10.00) \times (60\% \text{ chance of the contingency occurring}) \times (25\% \text{ chance that if the contingency occurs the court will be called on to resolve the dispute})—is less than the cost of doing so, $5.00. The difference between the “self-interested social isolates’” estimate of the likelihood that in the event of a dispute the terms of the contract and/or legal default rules will be used to resolve the dispute, assumed for simplicity to be 100%, and the relational transactors’ estimate of this probability, will be referred to as the “relational discount.” The existence of the relational discount suggests that in transactional contexts where relational ties are strong, the expected benefit of contracting around undesirable default rules may be small.

Relational factors may also affect the cost of contracting around default rules. In transactional settings where informal norms are an important part of the parties’ contracting relationship, a party may be reluctant to suggest varying a particular default rule even if the “direct transaction costs” are low and the variation would make both parties better off. Suggesting that a default rule be varied might be interpreted as a signal that the party suggesting the modification is more likely than previously thought to rely on his legal rights in the event of contract, late delivery, or non-conforming goods, may be strongly affected by relational factors. For example, in markets where reputation is important, a party (even a steely-eyed utility maximizer) may prefer to perform a contract (even one that is unprofitable) in order to maintain his reputation for meeting his commercial obligations.
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A dispute. If suggesting that a default rule be varied alters the other party's view of either the likelihood of a dispute arising, or the likelihood of both a dispute arising and winding up in court, this may affect his view of the costs and benefits of altering other provisions. Every time a default rule is varied by a contractual provision, the perceived benefit from contracting around other default rules increases since the perceived probability that default rules will be relevant to the parties' contracting relationship increases. Similarly, for every rule contracted around, the perceived cost of suggesting that an additional rule be varied decreases since the value of the "trust and cooperation" that this action will diminish is smaller.  

As a consequence, if party A proposes contracting around certain default rules, party B may find it worthwhile to propose that certain other default rules be altered to his advantage. Alternatively, he may either refuse to deal with party A or agree to do so only if party A offers a price adjustment to compensate him for the added perceived risk of litigation.

Similar barriers to contracting around default rules are also present even in transactional settings where the parties do not have long-term business or social relationships and tend to think about the transaction in terms of their legal rights and duties. Parties often approach contract negotiations with an idea of how similar transactions are usually structured; they have in their minds an implicit form contract made up of clauses such as price that are commonly negotiated, boilerplate provisions, and legal default rules. A party may be wary of

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41. The argument in the text does not suggest that once one party proposes contracting around a single default rule, an infinite chain of proposals and counterproposals will take place until the transaction breaks down or a complete contingent state contract has been drafted. Some default rules can be varied without sending a negative signal. In a sale of goods transaction, for example, proposing a price term is unlikely to send a negative signal, even though in the absence of a price term the court would enforce the contract and fill the gap with a reasonable price. U.C.C. § 2-305 (1990). In addition, in transactional contexts where there is an average level of drafting specificity that parties associate with particular transaction types, proposing certain types of contractual provisions, or proposing only a small number of provisions, might not trigger the process of proposal and counterproposal discussed in the text. Furthermore, when both parties view cooperation as important, there are a number of strategies they can adopt to prevent this unraveling from occurring and, over time, those strategies that effectively prevent this type of unraveling may evolve into well-established social norms.

42. As Todd Rakoff observes, "[i]n different social settings different norms are clustered around the practice of contracting itself... different norms about how many terms, and which terms, parties should specify." Todd D. Rakoff, Social Structure, Legal Structure, and Default Rules: A Comment, 3 S. Cal. InteroDisc. L.J. 19, 25 (1993).

43. Parties may be reluctant to alter boilerplate provisions that have been litigated in the past since the risk of legal error associated with highly tailored negotiated provisions may be higher. See Goetz & Scott, supra note 5, at 286. However, if the tailored contractual provisions are based on established industry norms and customs, and are accompanied by a wiseman clause
suggested too many deviations from the implicit form contract since this might be interpreted as a signal that he is a less reliable or more contentious trading partner than the average market participant. As in a relational setting, this signal might, in turn, lead the other party to either propose additional provisions or demand a price adjustment to compensate him for the added perceived risk that a dispute will arise. It might also increase the risk of transaction breakdown as well as the likelihood that the transaction will not be consummated by the relevant deadline.44

The existence of these relational costs of contracting around designating an industry expert to resolve all disputes in accordance with industry norms, parties who might previously have accepted the relatively untailored legal default rule in order to avoid increased adjudicative error costs, may now opt to include both a tailored substantive provision and an ADR clause. Thus, in some situations, ADR provisions may enable parties to capture the benefits of more tailored contractual provisions without increasing the risk of adjudicative error. They can also reduce drafting costs by reducing the need for specificity since a provision that might appear to be vague and standard-like to a judge, might appear clear and rule-like to an industry insider. As Todd Rakoff observes, in some situations in which there is a strong usage governing the trade, "[a] norm statement which to an outsider appears as a standard, may to insiders appear as a rule." For example, "substantial performance' might . . . have quite clear contours in the construction industry. Conversely, trade usage can make what is facially a rule into something which is in fact quite squishy; 'tender conforming in all respects to the contract' can become a standard if the contract terms themselves are understood by usage to allow for deviations to some degree, all things considered." Rakoff, supra note 42, at 26.

44. The effect of these risks on the value of the transaction will depend, in some measure, on the stage in the contracting process that the provision is proposed. The cost of bargaining breakdown may be low at the outset of the transaction if sunk costs are low and other trading partners are available. In contrast, transaction breakdown at the final stages of the negotiation may impose high costs on the parties in the form of sunk negotiation and transaction costs, as well as lost opportunities for profitable exchange. In later stages of the negotiating process, the potential benefit of extracting an additional dollar of value through inclusion of additional provision may be outweighed by the expected cost of the request—the increase in the likelihood of transaction breakdown multiplied by the cost of transaction breakdown. This suggests that Feinman's observation that "[i]n commercial behavior involving transactions of all types, parties often fail to bargain to the last dollar," Feinman, supra note 1, at 52, is not inconsistent with the assumption that many transactors are rational actors.

In addition, principal-agent problems sometimes lead the people who actually negotiate contracts to weigh the risk of transaction breakdown or failure to close by the relevant deadline more heavily than their actual effect on the value of the transaction. For example, a business manager whose superior gives her responsibility for concluding a transaction may be more concerned about closing the deal by the relevant time deadline than she is with the selection of the most desirable contractual provision or default rule that will apply in the event of a contingency that will happen, if at all, several years in the future. Similarly, a senior lawyer who is hired to conclude a transaction and who fears losing the client's business if he fails to do so, will give tremendous weight to the risk of negotiation breakdown or failure to close by the relevant deadline. Conversely, a junior lawyer may fear the consequences (such as loss of his job) of not having raised a particular contingency if it in fact comes to pass, and may therefore propose many provisions that actually decrease the value of the transaction.
default rules, together with the relational discount on the benefit of doing so, suggests that in many contracting contexts relational factors may influence parties’ negotiating and contracting decisions in ways that DRA must take into account if it is to provide useful guidance to courts and legislatures in deciding how best to deal with contractual gaps. The remainder of this section explores the ways that recognizing the importance of social norms and other relational factors in many transactional contexts might alter the analysis and conclusions of DRA.

A. Consent Theory

According to the consent theory, “when the transaction costs of discovering and contracting around the [legal] default rules are sufficiently low, a party’s consent to be legally bound, coupled with silence on the issue in question may well constitute consent to the imposition of the particular [legal] default rule . . . .” In contrast, when transaction costs are high, or at least one party is uninformed about the content of the legal default rule, consent to the imposition of the legal default rule cannot be inferred from silence. Courts should then use default rules reflecting “the commonsense expectations of the relevant community,” since they are most likely to accurately reflect parties’ subjective intent. However, in transactional contexts where the relational costs of contracting around default rules are high, and the relational discount on the benefit of doing so is large, even transactors who are well informed about the content of legal default rules and who could draft specific contractual provisions at relatively low cost might not choose to vary even those legal rules they find highly undesirable. Consequently, in transactional contexts where relational factors are important, it may be quite difficult to determine whether interpreting contractual silence as consent to imposition of

45. Marriage is an example of a contracting context where the relational costs of varying default rules (such as community property or equitable distribution) through a prenuptial agreement may be particularly high. During pre-marital negotiation, a desire to avoid any increase in the risk of “transaction breakdown” might make the parties reluctant to propose too many detailed contract provisions.

46. Barnett, supra note 4, at 866.

47. Id. at 880.

48. In Barnett’s view, “[i]t is usually rational for repeat players— even those who are relatively poor—to amortize over many exchanges the cost of obtaining this information [about the content of default rules] by retaining legal expertise.” Id. at 892. However, it is in precisely those situations where both parties are repeat players that the relational costs of contracting around default rules are likely to be the highest. As a consequence, if Barnett’s information and transactions cost rule were used to decide cases, and courts recognized the existence of relational
the legal default rule, or as a desire to be governed by conventionalist defaults, will be more likely to effectuate parties' subjective intent.\textsuperscript{49}

B. Economic Theory

The focus of Ayres and Gertner's economic theory of default rules is on how the structure and content of default rules can be used to influence parties' contracting behavior and create incentives for the largest possible number of transactors to include an efficient mix of default rules and specific provisions in their contracts. Because relational factors influence parties' drafting decisions, they will also affect the desirability of hypothetical bargain and penalty default rules.

In transactional contexts where the relational costs of contracting around default rules are high, and the benefits of doing so are small, the content of a default rule will have a weaker effect on parties' drafting decisions than it would in a transactional context where "self-interested social isolates" engaged in a discrete, arms-length transaction. As a consequence, in such contexts, it may be necessary to increase the magnitude of the penalty\textsuperscript{50} in penalty defaults in order to induce at least one of the parties to incur the relational costs of proposing a specific contractual provision.\textsuperscript{51} If, however, relational factors are so strong that the content of legal default rules will have little influence on parties' drafting decisions, it may be desirable for courts...
to use the hypothetical bargain approach to gap filling. Because the content of hypothetical bargain defaults is more likely to be efficient than the content of penalty defaults which are deliberately set at what one or both contracting parties do not want, hypothetical bargain defaults have significant advantages over penalty defaults in transactional contexts where the threat of penalty defaults is unlikely to influence parties' drafting decisions, and the court is therefore likely to be called upon to fill contractual gaps.

Penalty defaults may also induce parties to include specific provisions in their contracts in order to avoid any risk of the imposition of the penalty, even in situations where relational ties are so strong that it would be socially desirable to encourage the parties to leave the gap to be filled cooperatively at the time the contingency arises. Even if penalty defaults do not induce the parties to include a specific contractual provision in these situations, they may nevertheless be disadvantageous since they may reduce the likelihood that the parties will be able to fill the gap cooperatively at the time the contingency arises. Because penalty defaults are often deliberately constructed to disadvantage one party, they may give the other party more to gain by holding out for an adjudicated outcome than he would have if the court were to fill the gap using hypothetical bargain defaults. This, in specific contractual provision, the relational cost of contracting around them may be low. Proposing specific warranty provisions is, in most transactional contexts, as common as setting a price; it is thus unlikely to carry a negative signal.

However, in transactional contexts where the relational costs of proposing specific contractual provisions are not the same for both parties, penalty defaults may still be appropriate. For example, if a party with an established reputation for fair dealing is contracting with a new market entrant, the relational cost to the party with the established reputation of proposing a specific contractual provision may be small or nonexistent. In contrast, any changes proposed by the new entrant might lead quickly to transaction breakdown or a price adjustment to compensate the established party for bearing what he perceives as a greater-than-average risk that the new entrant will rely on his legal rights if a dispute arises. In these types of situations, a larger set of efficient contracts will be drafted if the default rule is set at what the established party does not want (a penalty default) since he is more likely than the new entrant to suggest additional contractual provisions.

Even if filling gaps with hypothetical bargain defaults increased parties' incentives to leave additional gaps in their contracts (since they would be able to shift the cost of specifying these terms to the court), the hypothetical bargain approach might nevertheless be efficient. In transactional contexts where relational factors are strong, the likelihood that a dispute will wind up in court is lower than in a discrete transaction. Consequently, the social loss that would result from the increase in the number of contractual gaps resulting from a hypothetical bargain approach may be less than the social loss that would result from filling gaps with penalty defaults (which are more likely than hypothetical bargain defaults to be substantively inefficient) in transactional contexts where relational costs prevented the parties from contracting around them.
turn, might increase the likelihood that the court will be called upon to engage in gap filling (particularly when it is noted that the parties are bargaining in a situation of bilateral monopoly), in which case it will have to fill the gap with the less efficient penalty term.

C. Summary

In sum, while recognizing the importance of relational factors in many contracting relationships does not undermine the logic of either the consent theory or economic theory of default rules, it does suggest that using these theories to structure legal default rules that will be applied to behavior along the full spectrum from discrete to relational exchanges may be more complex and less determinate than the proponents of these theories are willing to acknowledge.

Paradoxically, although Feinman maintains that DRA is useless since it focuses most of its attention on transactional settings in which the “event of contracting [i]s a self-interested, discrete transaction,” explicitly recognizing the effects of relational factors on parties’ negotiating and drafting decisions suggests that DRA’s focus on the “discrete” transaction may be justified. It is in precisely those situations where relational factors play a minimal role in the parties’ contracting relationship, that the parties’ decision to accept or draft around a particular default rule will be most strongly influenced by the content of the default rule and will have the greatest impact on the value of the transaction. In contrast, in situations where relational factors play a central role in the parties’ contracting relationship, the content of default rules may be viewed by transactors as peripheral—the relational discount on the benefit of contracting around default rules may be so large, and the relational cost of proposing changes so high that, regardless of the content of default rules, parties may not find it beneficial to contract around them.

III. FEINMAN’S RELATIONAL ALTERNATIVE

Feinman argues that DRA should be abandoned since “the assumptions underlying the analysis are unjustified, its predictive

54. Feinman, supra note 1, at 51.
55. Furthermore, since disputes between “steely-eyed utility maximizers” are the types of contract disputes most likely to wind up in court (since they are least likely to be resolved cooperatively), it is desirable for courts to use those default rules that would be most likely to induce such parties to draft socially desirable contracts.
power is poor, and its heuristic framework is biased.\textsuperscript{56} He suggests that it be replaced by a relational alternative—a system in which gaps in contracts are filled by reference to “norms, insights, arguments, and rules of thumb,” and courts strive to “reach just results in regulating behavior and providing remedies in cases of economic exchange.”\textsuperscript{57}

The central “feature of the relational approach is its focus on extensive factual inquiry.”\textsuperscript{58} designed to determine what kind of a relationship is most desirable in a given transactional setting. In making this determination, a court using a relational approach should take into account:

[T]he idea that a party should conform to the essential attributes of a role, status, or position that has been defined in a relation[,] . . .

the idea of mutuality, of a balance between benefits and burdens[,] . . .

the idea of balancing party planning against maintaining flexibility as relations develop[,] . . .

the idea of promoting trust and encouraging cooperation[,] . . . [as well as] the whole range of social policies and values other than those that grow out of the relationship.\textsuperscript{59}

It should then “restate the results [of its inquiry] in traditional doctrinal terms,”\textsuperscript{60} so that “over a large number of cases [relational analysis] may alter the terms of doctrinal analysis,” and contract law will increasingly reflect a deliberate “choice to emphasize certain policies developed from the law and certain aspects of the underlying social relations.”\textsuperscript{61}

Although Feinman maintains that his relational approach will lead to “just results in regulating behavior and providing remedies in cases of economic exchange,”\textsuperscript{62} it will decrease access to justice for poorer, more risk-averse litigants. In addition, to the extent that the relational approach seeks to rewrite the terms of the parties’ bargain\textsuperscript{63}

\begin{itemize}
  \item \textsuperscript{56} Feinman, \textit{supra} note 1, at 49.
  \item \textsuperscript{57} Id. at 54-55.
  \item \textsuperscript{58} Id. at 55. Although Richard Craswell maintains that the law-and-economics approach to DRA also requires extensive factual investigation, see Craswell, \textit{supra} note 2, at 93-94, the requisite inquiry is far more limited than would be necessary under Feinman’s relational approach, which strives to “open[ ] rather than foreclose[ ] inquiry.” Feinman, \textit{supra} note 1, at 56.
  \item \textsuperscript{59} Feinman, \textit{supra} note 1, at 56.
  \item \textsuperscript{60} Id. at 58.
  \item \textsuperscript{61} Id. at 57-58.
  \item \textsuperscript{62} Id. at 55.
  \item \textsuperscript{63} The redistributive bent of the relational approach is alluded to by Feinman when he explains that the approach is not based on a “sort of mindless empiricism, a mere application of existing social norms through rules of law.” Rather, it “contains a significant normative dimension that brings preferences and values to legal analysis . . . .” Id. at 57 n.30.
\end{itemize}
in an effort to further relational norms such as achieving a balancing of benefits and burdens, it may wind up limiting contracting opportunities for the types of parties relational standards seek to protect.\textsuperscript{64} Adopting the relational approach may also increase the cost of contracting since parties who seek to avoid the uncertainty associated with open-ended relational standards will draft increasingly detailed contracts.

A. Effects on Access to Justice

Filling gaps with relational standards and imposing "liability based on custom, usage, and social values in the absence of a specific text"\textsuperscript{65} may give judges additional flexibility to do justice in the individual case once a case is actually \textit{before them}. However, it will also create a systematic bias against poorer and more risk-averse litigants in the selection of disputes for judicial resolution.\textsuperscript{66}

Fact-based relational default standards will increase the cost of litigation, increase the uncertainty associated with adjudicative outcomes, and make it nearly impossible to resolve a case on summary judgment. Since contingent fee arrangements are not generally available in contracts cases, this increase in litigation costs may make adjudication inaccessible to poorer litigants and lower the settlement value of a claim.\textsuperscript{67} In addition, because the adjudicative uncertainty associated with the application of relational standards will impose greater

\textsuperscript{64} It may also create incentives for parties to restructure transactions in order to avoid bringing their relationship within particular relational paradigms. There is no reason to believe that these restructurings will be socially desirable.

\textsuperscript{65} Feinman, \textit{supra} note 1, at 55.

\textsuperscript{66} See, e.g., Robert W. Gordon, \textit{Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law}, 1985 Wis. L. REV. 565, 572 ("Parties with a lot of resources \ldots do not mind general equitable standards even if the substance of such standards cuts against them because they cannot practically be enforced without a lot of expensive evidence.").

\textsuperscript{67} The ability to threaten to impose high litigation costs will improve the bargaining position of the party with superior resources and may enable defendants with superior bargaining power to pay less in settlement than they would in a jurisdiction that applied a less fact-specific legal rule. At the outset of the litigation process, the minimum settlement a risk-neutral plaintiff will accept is his expected gain from going to trial—namely, his probability of prevailing multiplied by the amount he will recover if he prevails, less his litigation costs. Consequently, as the litigation costs that the defendant can threaten to impose on the plaintiff increase, the minimum amount he will have to pay to induce the plaintiff to settle the claim at the outset will decrease. Since relational standards increase the cost of litigation, they may enable defendants with superior bargaining power to pay less in settlement. In situations where the weaker party does not obtain an ex ante price adjustment to compensate her for the possibility that if a contingency arose she would settle for this amount, the application of the relational standard will leave her worse off than she would have been in a nonrelational jurisdiction.
costs on the more risk-averse contracting party, the less risk-averse party may be able to obtain a more favorable settlement in a relational jurisdiction than in a jurisdiction where the court would apply a more predictable legal rule.

B. LIMITS ON CONTRACTING OPPORTUNITIES

Many of Feinman's relational standards seek to reallocate wealth from one type of contracting party to another in an effort to do justice in the individual case and to further "the whole range of social policies and values other than those that grow out of the relationship." Although the relational approach may appear to protect the interests of less-powerful contracting parties by insisting that contractual obligations reflect mutuality and reciprocity, to the extent that it systematically rewrites certain types of bargains, it may decrease contracting opportunities for the types of transactors that relational standards seek to protect.

If, for example, courts routinely applied relational standards that tended to redistribute wealth from type A contracting parties to type B contracting parties, type A parties might become reluctant to deal with type B parties. Alternatively, they might agree to transact with type B parties, but only if detailed contracts that would avoid the risk of relational gap filling or interpretation were used, or they were able to obtain an ex ante price adjustment to compensate them for the risk.

68. It is also important to note that the uncertainty associated with the outcome of the application of relational standards might systematically disadvantage certain types of contracting parties, such as franchisees, upon whom legal uncertainty imposes especially high costs (again assuming that such parties do not obtain an ex ante price adjustment to compensate them for this risk); it might also leave such parties especially vulnerable to demands for additional performance during the life of the contract.

69. A risk-averse plaintiff will accept a much lower settlement offer than a risk-neutral plaintiff and a risk-averse defendant will agree to pay a much higher settlement than a risk-neutral defendant.

70. Filling gaps with the types of conventionalist default rules suggested by the consent theory may also limit access to justice for poorer, more risk-averse litigants since determining the content of conventionalist defaults would require the same type of expensive, fact-specific, subjective, and unpredictable inquiry that is needed to give content to relational standards.

71. Feinman, supra note 1, at 56. One goal of relational analysis is to encourage productive economic relations by determining what transactional structures have characterized productive and successful economic relations in similar contexts (or paradigmatic cases) in the past, and then reallocating the parties' rights and duties under existing contracts in an effort to replicate successful transactional structures. See Jay M. Feinman, The Significance of Contract Theory, 58 U. Cin. L. Rev. 1283, 1304-08 (1990).

72. See, e.g., Feinman, supra note 1, at 56.
of suffering a redistributive judgment in the event of a dispute.\textsuperscript{73} Since the application of relational standards will increase the cost to type $A$ parties of dealing with type $B$ parties, the use of such standards may decrease contracting opportunities for type $B$ parties.\textsuperscript{74} These opportunity-limiting effects are likely to occur whenever contract law seeks to systematically favor one type of contracting party over another by trumping the terms (either express or implied) of private agreements. As Judge Richard Posner observed:

The idea that favoring one side or the other in a class of contract disputes can redistribute wealth is one of the most persistent illusions of judicial power. It comes from failing to consider the full consequences of legal decisions. Courts deciding contract cases cannot durably shift the balance of advantages to the weaker side of the market; they can only make contracts more costly to that side in the future, because [the disfavored party] will demand compensation for bearing onerous terms.\textsuperscript{75}

\textsuperscript{73} The price effects of redistributive legal doctrines or legislation have been demonstrated empirically in a variety of settings. For an empirical study demonstrating that, in some markets, legal rules that protect franchisees by making it harder to cancel a franchise increase the price of the franchise, see James A. Brickley et al., \textit{The Economic Effects of Franchise Termination Laws}, 34 J.L. & Econ. 101 (1991). These types of price effects are typically dismissed as unimportant by relational scholars who cite franchisees' support for protective legislation as evidence of their desirability. For example, discussing the effects of such legislation, Macneil observes that "[i]n the case of franchising, the reduction of choice is one sided; regulations restricting the freedom of franchisors to terminate dealerships do not reduce choice for all participants." Ian R. Macneil, \textit{Values in Contract: Internal and External}, 78 Nw. U. L. Rev. 340, 377 (1983). However, Macneil's analysis ignores the possibility that the franchisees surveyed might not know how much these judicial and legislative protections raised the price of their franchise and that some franchisees might, if given a choice, have preferred fewer protections and a lower initial franchise fee. It also ignores the fact that those people who are already franchisees will benefit from the legislation until they next have to negotiate a price for renewal of their franchise.

\textsuperscript{74} Implementation of Barnett's theory of conventionalist defaults might have similar opportunity-limiting effects. Barnett suggests that "when parties have asymmetric access to the background rules of contract, [filling gaps with] conventionalist default rules will . . . provid[e] parties who are rationally informed of the background rules of law with an incentive to educate those parties who are rationally ignorant of these rules." Barnett, supra note 4, at 829. Although Barnett's rule will give a well-informed party who prefers the legal default rule some incentive to disclose its content to an uninformed party, it may also increase the cost to informed parties of transacting with less well-informed parties and thereby limit the contracting opportunities of less well-informed market participants. In some contexts, however, the cost of informing the less well-informed contracting party might be small (for example, in transactions concluded using standard form contracts that set out the relevant legal default rules as boilerplate) and, if most of the transactors that well-informed parties might deal with are uninformed, the opportunity-limiting effect of Barnett's rule may not be large.

\textsuperscript{75} The Original Great Am. Chocolate Chip Cookie Co. v. River Valley Cookies, Ltd., 970 F.2d 273, 282 (7th Cir. 1992).
C. SUMMARY

Although filling contractual gaps and resolving linguistic ambiguities by reference to "norms, insights, arguments, and rules of thumb" may give judges greater flexibility to do justice in the individual case, it will also increase litigation costs, create uncertainty, and make summary judgment nearly unavailable in contracts cases. As a consequence, the prospective effect of adopting such an approach may be to systematically decrease access to justice for poorer or more risk-averse contracting parties and, depending on the content of relational standards, to limit contracting opportunities for the types of transactors relational standards seek to protect.

IV. THE IMPLICATIONS OF THE AVAILABILITY OF ALTERNATIVE DISPUTE RESOLUTION FOR DRA

The widespread availability of binding private ADR has important implications for the questions and concerns that are at the heart of the default rules debate. Although DRA implicitly assumes that

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76. Feinman, supra note 1, at 54.
77. The "relational approach" to DRA may also undermine some of the norms that relational contract theorists seek to encourage. For example, it may create incentives for transactors who are disadvantaged by the legal uncertainty and high litigation costs created by the application of open-ended relational standards to draft detailed contracts containing relatively objective provisions. Such contracts might undermine the relational norm of "flexibility," a danger explicitly recognized by Feinman. See Feinman, supra note 71, at 1304 ("[i]mposing a norm of flexibility may cause parties to be more precise in specifying the terms of their contracts and therefore less flexible").
78. The failure to take into account the availability of ADR, and to conceive of ADR as a way of filling contractual gaps ex post, leads Easterbrook and Fischel to conclude that the need for corporate law (which they view as a set of contract default rules) can be explained by recognizing that, as compared to

law firms or corporate service bureaus or investment banks[, which could] compile sets of terms on which corporations may be constructed[,] . . . [c]ourt systems have a comparative advantage in supplying answers to questions that do not occur in time to be resolved ex ante. Common law systems need not answer questions unless they occur. This is an economizing device. The accumulation of cases dealing with unusual problems than supplies a level of detail that is costly to duplicate through private bargaining. To put it differently, "contractual" terms for many kinds of problems turn out to be public goods!

FRANK H. EASTERBROOK & DANIEL R. FISCHEL, THE ECONOMIC STRUCTURE OF CORPORATE LAW 35 (1991). This argument assumes that any institutions that might try to compete with the law and the court system for the provision of corporate law would have to do so ex ante. It completely ignores the possibility of including an ADR clause in a corporate charter designating a third-party neutral to supply "answers to questions that do not occur in time to be resolved ex ante." Id. Easterbrook and Fischel might, however, respond, that "[e]ven if law firms, investment banks, or other private suppliers of solutions could specify optimal solutions, . . . [n]o one firm could capture all of the gains from working out all problems in advance, because other firms could copy the answers without paying the creator." Id. While this might be true with respect to
contractual gaps must be filled by either legal default rules or detailed contractual provisions, ADR provisions provide parties with alternative ways of dealing with contractual gaps. In many transactional contexts, ADR provisions function as (1) substitutes for the legal default regimes (sets of default rules) provided by the state, (2) substitutes for the detailed contractual provisions that could be drafted by the parties, or (3) substitutes for reputation or other relational factors that distinguish “discrete” from relational exchange. When inclusion of an ADR provision is viewed as a way of selecting an alternative default regime, the consent theory's preference for conventionalist default rules may become more difficult to justify. Similarly, when ADR provisions function as substitutes for legal default regimes, detailed contractual provisions, or other relational factors, the economic theory's framework for determining the structure and content of optimal default rules may become more complex, and the information-revealing effect of penalty defaults may become weaker. In addition, to the extent that it is socially desirable to promote relational values in commercial relationships, encouraging the use of ADR may be a better way to do so than adopting Feinman's relational alternative.

A. Consent Theory

According to the consent theory, because “[t]he cost of ‘contracting around’ the existing package of [legal] default and immutable rules by resorting to extra-legal methods of assuring performance is exceedingly high... The choice to acquiesce to the legal background rules [under the current legal order] ... resembles the duress of the gunman’s demand of one’s money...”79 As a consequence, consent to the imposition of particular legal default rules cannot be inferred from parties’ failure to draft around them, and courts should fill gaps

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79. Barnett, supra note 4, at 903.
using conventionalist default rules since these are likely to “conform as closely as possible to the subjective agreement of the parties.” Barnett suggests, however, that if the cost of acquiring information about or contracting around legal default rules was lower, or jurisdictions competed in the provision of default rules so that the “legal system was more horizontal and less vertical,” it would no longer be necessary to fill gaps with conventionalist defaults. “[P]arties would then choose those legal systems that offer[ed] them the best overall package of default and immutable rules. Under these conditions, a general consent to be legally bound . . . might be construed as including a genuine consent even to those immutable rules that one cannot contract around.”

The legal system is, however, already far more horizontal than Barnett recognizes. Although state competition to provide desirable contract default rules may not be as intense as state competition to provide corporate default rules, in many transactional settings, parties nevertheless have a meaningful choice of legal default regimes. Parties can often choose to structure their transaction in a variety of ways, each of which is associated with a different legal default regime. In some contexts, partnership law, corporate law, or trust law can be effective, and sometimes superior, substitutes for contract law. Consider, for example, two people who want to produce featherbeds. One has the capital and the other knows how to produce the beds. These parties can go into business as partners, making partnership law the relevant default regime; they can form a corporation, making corporate law the relevant default régime; or they can enter into a contract, whereby the party who knows how to make the beds is engaged by the party supplying the capital for a salary and/or a percentage of the

80. Id. at 875. For a discussion of the reasons why conventionalist defaults are more likely than legal defaults to reflect the subjective agreement of the parties, see id. at 875-94.
81. Id. at 904.
82. Id. at 905.
83. Although states do not have the same incentives to compete in the provision of contract default rules that they do in the provision of corporate default rules (namely, incorporation fees and business for local attorneys), the widespread use of choice-of-law provisions suggests that parties must perceive some important differences among jurisdictions, otherwise they would not incur the costs of drafting these provisions.
84. The idea that corporate law and partnership law are, in some settings, substitutes for contract law is consistent with Coase’s theory of the firm, see R.H. Coase, The Nature of the Firm, 4 Economica 386 (1937), and Easterbrook and Fischel’s view of the corporation as a nexus of contracts, see Easterbrook & Fischel, supra note 78, at 34 (suggesting that “corporate law is a set of terms available off-the-rack so that participants in corporate ventures can save the cost of contracting”).
profit, making contract law the relevant default regime. Thus, in choosing among a variety of different transactional structures, parties are often, in effect, choosing among competing horizontal legal default regimes.

Parties' choice of default regimes is even broader once it is recognized that ADR provisions enable parties to inexpensively contract for any of a variety of competing extralegal "horizontal default regimes" to govern their transaction. There is substantial evidence to suggest that a shift to a more horizontal system of competing default regimes is being facilitated by the rapid growth in the use of ADR. Many industries have their own sets of transactional rules and/or specialized ADR programs. In the diamond industry, for example, as a condition of trading in the world's twenty diamond exchanges, transactors must agree to submit all disputes to the exchanges' own arbitration panels, which resolve them in accordance with an industry-specific commercial code as well as trade norms and customs. Many of these transactional rules are outright rejections of the rules that a court would apply.\textsuperscript{85} Similarly, the Chicago Mercantile Exchange requires all members to resolve many types of disputes through exchange-run arbitration and mediation tribunals which apply the exchange's own transactional rules.\textsuperscript{86} A number of other industries have codified industry-wide standards and have instituted industry-specific ADR programs.\textsuperscript{87} These codes and programs enable industry

\begin{itemize}
  \item \textsuperscript{85} See Bernstein, \textit{supra} note 38, at 154-57 (discussing the differences between the U.C.C. and the diamond industry's commercial code, as well as the differences between federal bankruptcy law and the diamond industry's bankruptcy code).
  \item \textsuperscript{86} See, e.g., Consolidated Rules of the Chicago Mercantile Exchange and the International Monetary Market Division and the Index and Option Market Division § 600(A)-(B) (1992).
  \item \textsuperscript{87} For example, most truth-in-advertising disputes between companies are submitted to the National Advertising Division of the Council of Better Business Bureaus, which has its own nonbinding arbitration tribunals whose decisions are typically accepted by the parties. See Council of Better Business Bureaus, Inc., National Advertising Division, National Advertising Review Unit \& National Advertising Review Procedures (1993). Similarly, ten of the country's largest food producers have agreed to attempt to resolve certain types of disputes among themselves through ADR for 90 days before litigating. \textit{Major Food Companies Agree to CPR Plan to Try ADR for 90 Days Before Filing Lawsuits}, 11 ALTERNATIVES 23, 23 (1993). Attempts are currently underway to persuade other industry participants to sign the agreement. \textit{Id}. In addition, the American Arbitration Association runs specialized ADR programs for many industries, including the textile industry, the construction industry, the securities industry, and the American Fats and Oils Association. It also has special rules that are designed to govern particular types of disputes such as the Accident-Claim Arbitration Rules, Multi-Employer Pension Plans for Withdrawal Liability Dispute Rules, Real Estate Valuation Arbitration Rules, Title Insurance Arbitration Rules, and Patent Arbitration Rules.
\end{itemize}
participants to obtain the benefits of highly tailored contractual provisions without incurring the transaction costs of drafting the types of detailed provisions that would be necessary to convey the content of industry-specific rules or norms to a court.

Over time, as parties and lawyers become increasingly aware of the ways that ADR provisions can be used to create and access alternative default regimes, and as industries and trade associations come to realize the benefits of drafting industry-specific commercial codes, the availability of competing extralegal default regimes is likely to pose an increasingly powerful challenge to the consent theory’s preference for conventionalist defaults, which is based in large part on the assumption that there is little competition in the market for the provision of contract default rules and that the existing legal order is essentially vertical. In addition, in some contracting contexts, as ADR provisions become more common, it will become increasingly difficult to determine what meaning of contractual silence is most likely to “conform as closely as possible to the subjective agreement of the parties.” For example, in contracting contexts where the transaction costs of including a wiseman provision—a provision requiring that all disputes be resolved by an experienced industry member in accord with industry custom—are low and parties have good information about the availability of ADR, it is no longer clear that parties who fail to include such a provision in their contract are likely to be expressing a preference that their transaction be governed by industry norms. Rather, the absence of such a provision might be taken to be a tacit signal of consent to be bound by legal default rules.

B. Economic Theory

The availability of ADR provisions and alternative default regimes also has implications for the economic theory of default rules.

88. See Barnett, supra note 4, at 882 (“Given that a default rule reflecting the commonsense expectations within the relevant community of discourse is likely to satisfy the parties’ intentions as well as or better than any rival default rule, there is strong reason to prefer it.”).

89. However, to the extent that ADR facilitates the creation of competing default regimes, its greater use is likely to be viewed favorably by consent theorists like Barnett, who have suggested that viewing consent as the basis of contractual obligation “may justify a more radical change in the legal system” to a more “horizontal legal order composed of competing legal systems, in contrast to the relatively vertical, monopolistic legal order we live in today.” Id. at 829.
It may affect both the type of contracting behavior it is socially desirable to encourage and the ways that parties respond to penalty default rules.

In certain transactional settings, it might be socially desirable to structure default rules to encourage inclusion of an ADR clause. For example, if the parties want their transaction to be governed by industry norms, it might be desirable for them to include a wiseman provision which designates a respected member of the industry to resolve all disputes according to industry norms and customs. The expected cost of the wiseman filling gaps will often be less than the cost to the parties of including specific contractual provisions ex ante, the expected cost to the court of filling gaps ex post, and the expected cost to the parties of cooperatively filling the gap at the time the contingency arises. Unlike contractual provisions detailing industry norms, wiseman provisions are inexpensive to draft. And, unlike judges who must determine the content of industry norms from the conflicting testimony of expert witnesses, wisemen are familiar with these norms and will therefore be able to resolve disputes more accurately and at a lower cost than a court. In addition, the relational costs of proposing a wiseman provision may be far lower than the relational costs of proposing numerous provisions detailing industry norms. Only one provision needs to be drafted, and proposing ADR might be viewed as a signal that a party prefers to resolve disputes cooperatively.

Although wiseman provisions and other ADR clauses can create joint gains for the parties, there are a number of barriers to parties' 

90. Although the inclusion of a wiseman provision will create an incentive for the parties to both draft fewer provisions and leave more issues for the wiseman to resolve, they will only do so if this is less expensive than including detailed contractual provisions since they bear the full cost of wiseman dispute resolution.

91. It is important to note that once a wiseman provision is included, the probability that the parties will cooperatively fill the gap at the time the contingency arises is likely to be much higher than it would have been without the provision, since neither party can threaten to inflict the cost and delay of litigation on the other.

92. Social norms and industry custom are often expensive to specify in a clear-enough manner to enable a judge or a jury to accurately apply them in the event of a dispute. Such norms often embody standards that transactors internalize over a long period of time. In many contexts, they cannot be stated with rule-like precision even by experienced industry members.

93. It has been suggested that while wiseman provisions are inexpensive to draft, the negotiation costs of including one are likely to be high since it may be difficult for the parties to agree on an acceptable neutral. Although this may be true in some transactional settings, such provisions are often included at the time of contracting when each party has an incentive to signal its preference for a cooperative rather than a litigious relationship.

94. For a discussion of the many ways that ADR clauses can create contractual value, see
including such provisions in their contracts. As a consequence, from a social perspective, it may be desirable to structure default rules in a way that will encourage parties who want disputes to be resolved according to particularized norms and customs to include an ADR provision in their contract. Courts might, for example, increase the costs taxed to the litigants or create a penalty default by refusing to look to industry custom in determining the content of legal default rules.

In addition to influencing the type of contracting behavior it is socially desirable to encourage, the availability of ADR may influence the ways that parties respond to penalty default rules. When a party is faced with one or more penalty defaults but is reluctant to include specific provisions contracting around them since doing so might reveal information that will trigger a price adjustment, she might find it advantageous to propose an ADR provision. Given the wide variety of reasons that parties find ADR provisions attractive, including an ADR provision directing a third-party neutral to use a particular default regime in resolving a variety of disputes may weaken, though perhaps not entirely eliminate, the informational signal sent by proposing to contract around a particular default rule. Thus, when ADR provisions are used in this manner, the information-revealing effects of penalty defaults may be weaker than the economic theory suggests.


95. As discussed earlier, standard-like default rules that increase uncertainty, delay, and the cost of litigation tend to advantage large, less risk-averse contracting parties who can afford to lay out litigation expenses, and who are better able to bear the costs of delay. As a consequence, these types of parties are often reluctant to include ADR provisions since, if a dispute arises, their superior resources and ability to bear the cost of delay might enable them to settle on more favorable terms than they would be able to obtain if the dispute could be quickly and inexpensively resolved through ADR. For a detailed discussion of the ways that asymmetric risk aversion and the asymmetric ability to bear the costs of delay create barriers to parties including ADR provisions in their contracts even when doing so could produce private benefits, see id. at 2193-95.

96. Another way to encourage the use of ADR provisions is to attempt to reduce the tremendous bargaining advantages that stronger, less risk-averse contracting parties obtain from having their contract disputes resolved through the legal system. This suggests that rule-like defaults may be more likely to encourage parties to include ADR provisions since they reduce the bargaining advantage the stronger party gains from being able to threaten to litigate.

97. Parties may prefer to resolve disputes through ADR rather than litigation for a variety of reasons such as cost savings, informality, reduction of delay, and the benefits of an expert adjudicator. For a more extensive discussion of the myriad of reasons parties use ADR, see Bernstein, *supra* note 94, at 2239-53.
Inclusion of an ADR provision may also provide a way for parties to a discrete transaction to capture some of the benefits of a continuing relational exchange. In contracting contexts where parties would prefer not to include too many specific contract provisions, perhaps because drafting costs are high, relational costs are significant, or contingencies cannot be adequately anticipated, but parties do not have a strong enough relationship to be willing to leave gaps to be cooperatively filled at the time a contingency arises, they may find it desirable to leave certain types of disputes to be resolved by a wiseman under a clause directing him to reconstruct the parties' hypothetical bargain. When used in this manner, wiseman provisions function as substitutes for the parties' reputations; they can enable parties to a discrete exchange to capture many of the benefits of a continuing relational exchange. They can also help transform contracting relationships that begin as discrete exchanges into continuing relational exchanges by providing a mechanism for resolving disputes or disagreements that arise before the parties fully trust one another enough to be willing to rely on their ability to reach cooperative agreements.

In sum, when traditional adjudication is viewed as a default rule, the economic theory suggests that legal default rules should be structured to create incentives for parties to draft contracts that have not only the optimal mix of specific provisions and default rules, but also the optimal mix of terms to be adjudicated in a legal forum, resolved through ADR, or left solely to extralegal norms and institutions.

C. The Relational Alternative

ADR tribunals may be better than courts in applying relational standards and promoting relational values. One goal of relational adjudication is to reach results that fit in harmoniously with the existing "social matrix."98 Such results are more likely to occur when the adjudicator is drawn from the relevant social community. Similarly, to the extent that the informality of some ADR proceedings enables parties to amicably resolve disputes, ADR is more likely than litigation to further the norm of "preservation of relations."99 Furthermore, unlike judges who are able to award only money damages

98. See Macneil, supra note 73, at 346-49.
99. For a discussion of the importance of this norm, see id. at 377-78. A desire to resolve disputes while preserving the relationship between the parties is one of the primary motivations behind the recently created National Franchise Mediation Program under which signatory franchisors attempt to mediate disputes with franchisees. See Franchisors Form Special ADR Vehicle, 11 ALTERNATIVES 37, 37 (1993) (noting that "mediation has advantages not available
or specific performance, arbitrators and other third-party neutrals can fashion creative remedies designed to preserve the value of the parties' relationship. They might, for example, require or encourage joint control over a resource in dispute. In short, if ADR can achieve the goals its proponents suggest, it may be a more effective way to promote relational values in commercial relationships than Feinman's relational alternative, even in situations where the third-party neutral does not explicitly apply relational standards of the kind Feinman proposes. In addition, since ADR proceedings can be conducted shortly after the dispute arises and are often far less expensive than litigation, implementing Feinman's relational alternative through ADR rather than litigation will reduce, though not eliminate, some of its undesirable distributional effects.

through the adversarial process that previously dominated dispute resolution in the [franchise] industry... [M]ost notably, it provides the opportunity to preserve productivity and the underlying business relationship.

100. See, e.g., Ian R. Macneil, Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus," 75 NW. U. L. REV. 1018, 1033 (discussing "the need in relational contract to cooperate in planning in the future, planning that will involve exercises of choice").

101. See STEPHAN B. GOLDBERG ET AL., DISPUTE RESOLUTION: NEGOTIATION, MEDIATION, AND OTHER PROCESSES 7 (2d ed. 1992) (discussing the hope of ADR proponents that "expanded use of informal [dispute resolution] methods in this country would result in resolutions more suited to parties' needs, reduced reliance on laws and lawyers, rebirth of local communities, maintenance of long-term relationships, and relief for nonparties affected by the conflict").

102. See, e.g., Ian R. Macneil, Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law, 72 NW. U. L. REV. 854, 879 (1978) (discussing the ways that ADR provisions can be used to help promote relational values and noting that "[p]rovisions for meeting together to discuss problems, for mediation in the event of a dispute, and for arbitration are all examples of planning which tends to keep relations going").

103. Although ADR proceedings can be as costly and delay-prone as litigation, parties who prefer an inexpensive proceeding conducted shortly after a dispute arises can include provisions designed to further these goals. They might, for example, include a provision limiting the amount of pre-arbitration discovery permitted, a provision requiring the arbitration to be commenced a fixed number of days after an official request is filed, or a provision requiring the hearing to be conducted on consecutive days.

104. As discussed in the text, one of the main ways that ADR provisions can create value is by enabling parties in a discrete arms-length exchange to capture many of the benefits of continuing contractual relationship characterized by trust and strong relational ties. Consider, for example, two "self-interested social isolates" who do not trust one another but want to enter into a transaction where flexibility about the types of raw materials to be used in a manufacturing process is important since raw material prices fluctuate widely over time. The parties would like to draft a clause giving the manufacturer the right to make substitutions that do not unduly impair the quality of the goods, but the buyer is reluctant to agree to such a clause since the cost of enforcing it in court will be high and he has no reason to think that the manufacturer will act in good faith. In such a situation, the parties can designate a wiseman whose reputation they
Thus, using default rules to selectively encourage the use of ADR is consistent with Feinman's relational alternative, since more widespread use of ADR will promote relational values. It is also consistent with the economic theory of default rules since it is sometimes socially desirable to encourage parties to include ADR provisions directing a third-party neutral to resolve disputes by applying social or industry-specific norms, or to fill contractual gaps by reconstructing the parties' "hypothetical bargain." Encouraging the use of ADR is also consistent with the consent theory, not only because it will facilitate the development and accessibility of competing default regimes, but also because third-party neutrals who are part of the "relevant community of discourse" are more likely than generalist judges\textsuperscript{105} to discern the "commonsense understanding of the parties" and to render decisions that will "conform as closely as possible to the [parties'] subjective agreement."\textsuperscript{106}

V. CONCLUSION

This comment has argued that while the effects of social norms and other relational factors on parties' contracting behavior must be taken into account in any theory of default rules that seeks to influence, interpret, or reconstruct the contracting process, relational standards should be not be used to fill gaps and interpret contracts. It has explored the ways that the core insights of relational contract theory can be integrated into the leading academic approaches to DRA, and has demonstrated that giving social norms the prominence they deserve does not, as Feinman maintains, require a rejection of DRA or abandonment of the assumptions of rationality and self-interest. Rather, understanding a contracts' relational context may help an adjudicator more accurately determine the parties' subjective intent, and may help courts and legislatures more accurately assess the social desirability of different types of legal default rules.

\textsuperscript{105} See Barnett, supra note 4, at 907-08 (discussing how to determine the commonsense understanding of the parties and suggesting that "[t]o the extent that judges are selected from the relevant community of discourse, they may discover the commonsense understandings of the parties ... by introspection").

\textsuperscript{106} Id. at 875.
I am no more an aficionado of the relational contract literature than Jay Feinman is of the literature on default rules. However, I have always been troubled by a sense that I ought to like relational analysis better than I in fact do. After all, those who analyze contracts from a relational perspective are seriously committed to their work. I flatter myself that I am capable of learning from those who are not my soulmates, and I have indeed learned from the criticisms relational scholars have addressed to my own preferred method, economic analysis.

Why, then, have I not been able to learn from these scholars' distinctively relational analysis?

Professor Feinman's contribution to this symposium provides an opportunity to address this issue. In fact, I agree with Professor Feinman that our two modes of analysis are trying to answer different questions. From my point of view, relational analysis seems frustratingly indifferent to the questions I am interested in, while the questions it does ask seem to me to be largely irrelevant.

Before elaborating on these differences, some clarification may be necessary. Economic analysts sometimes use the phrase relational contract as little more than a synonym for a contract which is incomplete in some important sense. These analysts then use economics to identify the most efficient solution to this incompleteness. This is not what Professor Feinman means by relational analysis, and it is not...