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## The Relational Economics of Commercial Contract

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# THE RELATIONAL ECONOMICS OF COMMERCIAL CONTRACT

By: Chapin F. Cimino\*

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## I. INTRODUCTION

Modern contract law scholarship embraces a particularly strange contradiction. On one hand, most legal scholars accept the core insight of what is called *relational contract theory*: most commercial contracts involve repeat players who seek to maximize wealth while still maintaining cooperative relationships. On the other hand, many of these same contract scholars believe that there is nothing contract law

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could or should do about it. They contend that contract law and legal theory are better off ignoring this insight, rather than trying to respond to it.

This puzzling state of affairs resulted from a disconnect between the objectives of mainstream contract scholarship and the goals of relational contract scholars. For the past half-century, law and economics has played the dominant role in contracts scholarship. Scholars in this tradition value the prediction of behavior based on a cost-benefit analysis over the ability to precisely describe the world in which that behavior occurs. Meanwhile, relational contract theory scholars, working in the tradition of law-and-society, pursue a different objective. They seek to provide an accurate account of the world of contracting, as performed by actual parties. Thirty years ago, Ian Macneil offered a rich description of actual contract behaviors that refuted the one-off model of “strangership” transactions.<sup>1</sup> By now, most mainstream legal scholars accept Macneil’s findings. His account has proven so powerful that even scholars in the law and economics camp have conceded that his description is largely accurate as a factual matter. Thus Robert Scott has said, “We are all relationalists now. . . . Macaulay and Macneil have swept the field.”<sup>2</sup>

It turns out, though, that Scott is only half right. With a few exceptions,<sup>3</sup> most law and economics scholars have not integrated Macneil’s insights into their theoretical or doctrinal accounts.<sup>4</sup> One reason they

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1. Ethan J. Leib, *Contracts and Friendships*, 59 EMORY L.J. 649, 654–55 (2010) (using the term “strangership” to describe the old model of contract law).

2. Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 852 (2000).

3. See, e.g., Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927, 984–90 (1990) (advocating for a doctrinal implementation of a relational approach (i.e., one that accounts for the norms and practices within the franchise relationship) to the unique problems of “necessarily incomplete” franchise contracting through the doctrine of good faith and fair dealing).

4. There are varying reasons why not. To preserve predictability, Robert Scott favors a formalist interpretation of contract law. Scott, *The Case for Formalism in Relational Contract*, *supra* note 2. Others question the ability of courts to engage in contextual analysis. See Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 773–74 (2000); see also John Kidwell, *A Caveat*, 1985 WIS. L. REV. 615, 615, 619–20 (despite “consider[ing] myself a friend of the relational contract perspective,” arguing in favor of preserving contract law’s model of “Contract-as-Transaction” and rejecting the call to reformulate contract law based on (the more empirically accurate) model of “Contract-as-Relation” because, in the end, courts are not equipped to handle “all the facts and circumstances,” and so “for legal doctrine to serve the communicative function of the courts, doctrine must be, to some extent, formal”). Still others question both whether trade customs actually exist, see Richard Craswell, *Do Trade Customs Exist?*, in THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW 118 (Jody S. Kraus & Steven D. Walt eds., 2000), or if they did, whether business people would want courts to apply them in litigation, Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1820 (1996) (“[T]he Code’s highly contextualized approach to adjudica-

have not done more with relational contract theory is the ease and simplicity of the classic economic model.<sup>5</sup> Indeed, traditional first-generation law and economics rejected the implications of this research entirely. More recently, a number of law and economics scholars studying contract design and the problem of incomplete contracting have quietly relaxed some of the strictest traditional assumptions about human behavior<sup>6</sup>—such as accepting bounded rationality<sup>7</sup>—in ways

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tion is flawed because it mistakenly assumes that transactors' actions under a contract are the best indication of what they intended their writing to mean, when in fact these actions are likely to reflect the RPNs transactors find it desirable to follow when they cooperatively resolve disputes, not the EGNs they would want a court to apply if they wind up in litigation.”). Similarly, Alan Schwartz doubts that commercial agreements are likely to develop “rich sets of local norms.” Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 276 (1992) (“Commercial relationships, in contrast [to the relationship between a firm and its labor unions], seem too unifacted—too thin—to generate rich sets of local norms. The parties to a long-term coal contract thus may exchange only telephone calls and letters after the contract is negotiated.”).

5. See Kenneth G. Dau-Schmidt, *Economics and Sociology: The Prospects for an Interdisciplinary Discourse on Law*, 1997 WIS. L. REV. 389, 394–97 (noting that, in order to make predictions about economic phenomena “not . . . yet observed,” economics relies upon “assumptions about the world that abstract the essential features of the examined problem,” and that “[a] core assumption of the neoclassical model is that people are rational maximizers of some good, for example[,] utility, wealth[,] or profits. Economists have a well-defined notion of what it means to be a rational maximizer, assuming that people have preferences with respect to all possible choices, that these preferences are reflexive and transitive, and that the individual will choose the available option which he or she most prefers. . . . With preferences held constant, economists explain changes in human behavior by postulating the existence of costs . . . which influence behavior. . . . A final set of core assumptions for the neoclassical model are that transactions and information are costless. These assumptions facilitate modeling and bolster the efficacy of markets in coordinating individual actions.” (footnotes omitted)); see also EIRIK G. FURUBOTN & RUDOLF RICHTER, INSTITUTIONS AND ECONOMIC THEORY: THE CONTRIBUTION OF THE NEW INSTITUTIONAL ECONOMICS 34, 47 (2d ed. 2005); Oliver E. Williamson, *The Economics of Organization: The Transaction Cost Approach*, 87 AM. J. SOC. 548, 554 & n.9 (1981) [hereinafter Williamson, *The Economics of Organization*] (“[S]tandard ‘economic models . . . [treat] individuals as playing a game with fixed rules which they obey. They do not buy more than they can pay for, they do not embezzle funds, and they do not rob banks.” (quoting Peter Diamond, *Political and Economic Evaluation of Social Effects and Externalities: Comment*, in FRONTIERS OF QUANTITATIVE ECONOMICS 31 (Michael D. Intriligator ed., 1971))).

6. See Rudolph Richter, *The Role of Law in the New Institutional Economics*, 26 WASH. U. J.L. & POL’Y 13, 35–36 (2008) (“[N]ewer literature [in law-and-economics] is developing that takes up core issues of Williamson’s TCA—without going back to his work, but starting directly from the much narrower approach of the mathematical theory of incomplete contracts that developed from TCA.” (citing Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RES. L. REV. 187 (2005); Steven Shavell, *Contractual Holdup and Legal Intervention*, 36 J. LEG. STUD. 325 (2007); and Richard Craswell, *The “Incomplete Contracts” Literature and Efficient Precautions*, 56 CASE W. RES. L. REV. 151 (2005))).

7. See, e.g., Benjamin E. Hermalin et al., *Contract Law*, in 1 THE HANDBOOK OF LAW AND ECONOMICS 68–99 (A. Mitchell Polinsky & Steven Shavell eds., 2007) (Section 4, Interpretation of Contracts: Contractual Incompleteness) (noting that “[c]ontractual incompleteness captures the idea that real-life contracting can fail to

that would be compatible with a broader relational account of contracting behavior within an economic framework. Nonetheless, relational contract theory remains on the margins of contract law scholarship.

This Article brings these disparate lines of contract scholarship together by introducing new information that could dramatically change how legal scholars make sense of relational contract theory. It turns out that while legal scholars have largely discounted the importance of relational contract theory, another community of scholars—working in organizational theory, marketing, and strategic management—have studied, tested, and developed its insights. As a result, they have not only empirically confirmed the presence of relational behaviors in modern contracting, but they have begun to discover the sort of data that might make it possible to better account for the economic effects of relational contracting behavior in both legal theory and contract law doctrine. This literature demonstrates that it is possible to operationalize the insights of relational contract theory in an interdisciplinary way that respects both the need for a methodologically rigorous framework and the complex nature of economic behavior.<sup>8</sup> In this Article, I argue that contract law scholars should set out on that same course.

Because this literature has not been discussed previously in contract law scholarship, its potential impact is vast. To fully harvest it, contract scholars in law may need to partner with colleagues in business schools to design a new wave of interdisciplinary research. The agenda would be to elicit, for the first time, information about the economic aspects of contractors' relational expectations. The new research could impact work on contract design, problems of opportunism, and the interaction of relational and formal commitments, just to name a few. Of course, the details of such a new interdisciplinary approach would take years to work out, and that is not the goal of this project. Instead, this Article argues that as we continue to debate the proper role of social and relational context in contract law, we ought to consider the data that shows both the prevalence of relational behaviors and how to operationalize social context.

This Article proceeds as follows. Part II describes the distinctive nature of relational contract theory. This Part describes how relational contract theory provides an insightful account of modern commercial

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produce contracts that are as precise and detailed as traditional—albeit possibly naïve—economic theory predicts”). For a discussion of the perceived trade-off between the predictability of neoclassical contract law and the flexibility that a more relational contract law would have, see Henry N. Butler & Barry D. Baysinger, *Vertical Restraints of Trade as Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory*, 32 EMORY L.J. 1009, 1037–41 (1983).

8. Kenneth G. Dau-Schmidt has noted that economists required the former, and sociologists require the latter. Dau-Schmidt, *supra* note 5, at 390.

contracting and has equipped economic analysts to work with both contracting's economic and social sides. Ironically, the very insight that distinguishes relational contract theory from mainstream contract theory—that relational contract behaviors are economic contract behaviors—is the same insight that the business social science scholars have found indispensable.

Part III moves to the heart of this project. This Part shows how, as reported in the business social sciences literature, marketing and management scholars have economically operationalized relational concepts. To do this, Part III first briefly explains the analytic framework used in this work (transaction cost economics, or "TCE"). Then the Article highlights a few representative studies testing for, first, what Macneil called the "common contract norms," such as solidarity and reciprocity, and second, the background social context of particular exchange relationships. The Article offers by way of illustration a few examples of each, beginning with early, generative work, and concluding with recent work that built on those foundations. With these examples, the Article demonstrates that there is significant empirical evidence to show that contractors do routinely embrace relational norms and that relational norms and social context have instrumental, quantifiable effects on exchange.<sup>9</sup>

Part IV considers just some of the possibilities and challenges of operationalizing relational contract behaviors in law. First, economically operationalizing relational contract in legal scholarship will require new research methods, including approaches from transaction cost economics as well as less formal and more descriptive methods.<sup>10</sup> Second, research operationalizing relational contract could identify patterns of economic incentives and effects driving relational expectations. These patterns could inform transactional work and reveal patterns of "immanent commercial law," which Karl Llewellyn originally envisioned as evidence in commercial litigation.<sup>11</sup> Third, along with possibilities come challenges. Here, one challenge is determining how to convert findings in academic research to evidence in commercial litigation. Fourth, operationalizing relational contract may inform works in progress in other disciplines seeking to broaden narrow economic conceptions of wealth maximization and self-interest. Finally, in Part V, the Article concludes.

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9. For the economist, these effects are important predictors of particular governance strategies that firms will likely employ in the context of inter-firm bilateral exchange. For the sociologist, these effects are confirmation that the influence of social realism can enhance, rather than detract, from those predictions.

10. For a recent notable example incorporating institutional and organizational perspectives, see D. Gordon Smith & Brayden G. King, *Contracts as Organizations*, 51 ARIZ. L. REV. 1 (2009). For an earlier notable example, see Butler & Baysinger, *supra* note 7.

11. Robert E. Scott, *Is Article 2 the Best We Can Do?*, 52 HASTINGS L.J. 677, 688 (2001).

## II. THE DISTINCTIVE PLACE OF RELATIONAL CONTRACT THEORY

Unlike most other theories of contract law, relational contract theory is not grounded in law at all. Instead, it is an interdisciplinary theory grounded in sociology. Similarly, unlike most theories of contract law, relational contract theory does not try to harmonize caselaw or to predict the effects of legal rules according to a single normative value, such as efficiency or autonomy. Indeed, in developing what we now know as relational contract theory, Ian Macneil did not intend to explain the law *or* create a new theory.<sup>12</sup> Rather, Macneil's goal was to test the accuracy of the exclusively individualistic, competitive vision of contract.<sup>13</sup> As it turned out, however, Macneil's observational experiment did become a theory. In this Part, the Article describes his work in more detail.

### A. *Relational Contract Theory's Grounding in Sociology*

Though relational contract theory today has many masters, it began with the Wisconsin School of new-realist law-and-sociology research pioneered by Stewart Macaulay and Ian Macneil.<sup>14</sup> Macaulay and Macneil were law scholars, but they used the tools of sociological research: data collection and observation. The early research—circa 1960s—made clear that the real world of contracting does not look like the casebook world of contracting. Real contracts do not occur primarily between strangers engaged in fixed duration, one-shot deals but rather extend over time, between contractors with developed and perhaps long-standing relationships.<sup>15</sup> This work proved fruitful and

12. For purposes of this Article, I mean to refer to the work that Ian Macneil later referred to as “essential contract theory.” See Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 NW. U. L. REV. 877, 892–93, 892 n.55 (2000) [hereinafter Macneil, *Relational Contract Theory*] (outlining three different versions of his own relational contract theory, including that which is the topic of this Article: “the ideas growing out of my own descriptions of common contract behavior and norms”).

13. See David Campbell, *Ian Macneil and the Relational Theory of Contract*, in THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL 3, 9 (David Campbell ed., 2001). That said, Campbell then goes on to say that “[b]y doing so, he [Macneil] has attempted to construct a coherent and relevant rival law of contract.” *Id.* at 9. I disagree with that assessment. Instead, I believe that if Macneil had read that sentence, he might have challenged David Campbell to a duel. See Macneil, *Relational Contract Theory*, *supra* note 12, at 899 (“I challenge to a duel anyone who, after this notice, persists in converting my descriptions of relational contract into prescriptions of what the law should be, particularly of some universal application of relational contract law.”).

14. As to competing claims to authorship, see Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2009 & n.9 (“Ian Macneil has written: ‘My students all . . . know that I invented relational contract . . .’ Amazingly, my students know that Goetz and I invented relational contract.” (internal references omitted)).

15. See Leib, *supra* note 1, at 654 (noting that relational contract theory's biggest success is in debunking the “strangership” model of contracts).

led contract law scholars in multiple directions, including asking whether the law actually mattered to contractors and how real world contractors actually settled disputes.<sup>16</sup>

Macneil's version of relational contract theory is very specific, however. It begins with Macneil's view that the origins of any contract lay in background social context.<sup>17</sup> To Macneil, all contracts share what he called "four primal roots."<sup>18</sup> By "primal" he meant phenomena that exist *before* any contracting happens, and by "roots" he meant the *phenomena* from which all contracting behaviors grow.<sup>19</sup> The roots he identified are: "(1) a social matrix; (2) specialization of labor and exchange; (3) a sense of choice; and (4) conscious awareness of the past, present, and future."<sup>20</sup> By using the roots metaphor, Macneil asserted that the institution of contract—all contracts, any contract—grows out of a social background. The social background consists of contracting actors aware of each other, aware of their community, aware of the self and other's places in their community, and aware that this moment is only one moment in time. As these awarenesses precede any actual contract dealings, unavoidably, contract grows out of these roots. Thus, no economic exchange—no transaction, no contract—lacks a relevant social background.<sup>21</sup>

From that starting place, two key phenomena emerge as the heart of the theory's normative framework: first, some mix of what Macneil called the ten "common contract norms" are present in varying degrees in all contracting behavior;<sup>22</sup> and second, all contracts fall somewhere along what he called a relational "spectrum" of contracts, from the more relatively discrete, though still relational, at one end, to the

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16. See, e.g., Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58–59 (1963); see also David Campbell, *What Do We Mean by the Non-Use of Contract?*, in REVISITING THE CONTRACTS SCHOLARSHIP OF STEWART MACAULAY 159, 165 (Jean Braucher, John Kidwell & William C. Whitford eds., 2013) (challenging premise that doing business in the "shadow" of a contract is the same as "not using" the contract).

17. See, e.g., IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS* 1 (1980).

18. *Id.* at 1–4 (describing each of the four primal roots).

19. Macneil does not explain exactly what he means by "primal roots"—this is my interpretation. See *id.*

20. Macneil, *Relational Contract Theory*, *supra* note 12, at 879.

21. Campbell, *What Do We Mean by the Non-Use of Contract?*, *supra* note 16, at 184 (making the point that, without a sufficiently co-operative social structure, there can be *no* exchange: "The law of contract must be seen as a fundamentally co-operative structure making the self-interested exchange possible within legitimate channels.").

22. Ian R. Macneil, *Values in Contract: Internal and External*, 78 NW. U. L. REV. 340, 351 (1983) [hereinafter Macneil, *Values in Contract*] ("[S]ince the common contract norms are present in all contracts, they give rise to whatever values emerge from all contract behavior and our assessment of it. . . . The only time these norms are not present and therefore do not give rise to oughts is when contract is not operating. Nevertheless, they do not necessarily blossom fully in all contractual relations at all times.").



more relatively relational at the other end.<sup>23</sup> And, as will be demonstrated in Part III, it is precisely these two key aspects of contracting that have been successfully evidenced and operationalized in the business social science literature. Because of their importance in that literature, each will be discussed more fully in turn.

The first phenomenon is that all contractors behave in similar ways, but to varying degrees. As noted, Macneil called these behaviors the common contract norms.<sup>24</sup> He called them norms because he saw them as descriptions of the normal nature of all contract activity.<sup>25</sup> Macneil argued that these norms are present in some combination and to some degree in all contracting behavior—they could only be missing if a contract “is not operating.”<sup>26</sup> Macneil asserted that the solidarity and reciprocity norms are present in every contract, while the others may be present in varying degrees of intensity given the nature and experience of a particular relationship.<sup>27</sup> The ten common contract norms are:

- (1) role integrity (requiring consistency, involving internal conflict, and being inherently complex); (2) reciprocity (the principle of getting something back for something given); (3) implementation of planning; (4) effectuation of consent; (5) flexibility; (6) contractual solidarity; (7) the restitution, reliance, and expectation interests (the

23. Macneil, *Relational Contract Theory*, *supra* note 12, at 894.

24. Macneil, *Values in Contract*, *supra* note 22, at 348.

25. Macneil uses Webster’s definition of “norms,” which is: “a principle of right action binding upon the members of a group and serving to guide, control, or regulate proper and acceptable behaviour.” Campbell, *Ian Macneil and the Relational Theory of Contract*, *supra* note 13, at 11–12 (quoting IAN R. MACNEIL, *THE NEW SOCIAL CONTRACT* 38 (1980)). That said, there is an important difference in what Macneil meant by the word “norm” and the way the term is used in the “law and social norms” literature. That literature starts from a place of trying to understand and explain how law incentivizes individual action, and holds that one cannot fully understand that relationship without accounting for norms of group behavior that may have been internalized by an individual. See generally Robert E. Scott, *The Limits of Behavioral Theories of Law and Social Norms*, 86 VA. L. REV. 1603, 1608–09 (2000) (using “the case of the devoted dog lovers” as an illustration of the limits of law and social norms accounts). Macneil was not interested in, and was not discussing, that topic. For discussions of the “law and social norms” literature that does discuss contract law’s impact on contracting behavior and the role of “social norms” in that context, see generally Mark Cooney, *Why is Economic Analysis So Appealing to Law Professors?*, 45 STAN. L. REV. 2211 (1993) (reviewing ROBERT C. ELLIKSON, *ORDER WITHOUT LAW* (1991)); see also Dau-Schmidt, *supra* note 5, at 407 (arguing and then explaining that “there are three basic implications of sociology for the economic analysis of law: first, rational actors belong to groups; second, what is rational may be influenced by internalized norms of cooperation; and third, the law is part of the process for internalizing norms of behavior”).

26. Macneil, *Values in Contract*, *supra* note 22, at 351 (“[S]ince the common contract norms are present in all contracts, they give rise to whatever values emerge from all contract behavior and our assessment of it. . . . The only time these norms are not present and therefore do not give rise to oughts is when contract is not operating. Nevertheless, they do not necessarily blossom fully in all contractual relations at all times.”).

27. *Id.* at 348–49.

“linking norms”); (8) creation and restraint of power (the “power norm”); (9) propriety of means; and (10) harmonization with the social matrix, that is, with supracontract norms.<sup>28</sup>

Importantly, because all contracting behavior can be described by some mix of these ten common contract norms (where all mixes include at least solidarity and reciprocity), these behaviors have become more than just descriptions. They have become part of the normative framework of the theory.<sup>29</sup>

The second phenomenon is that all contracts fall somewhere along a single continuum, which Macneil called the relational contract “spectrum.”<sup>30</sup> The more discrete engagements—the closer any one contract is to the imagined paradigm of a one-off contract—fall on one end, while the most highly relational fall on the other.<sup>31</sup> All others fall somewhere in between. No contract is off the spectrum.<sup>32</sup>

More discrete engagements are characterized by what Macneil called the “discrete norm.” The discrete norm is another way of saying that two of the ten common contract norms reflect behaviors that appear most often in relatively discrete transactions. Those are the implementation of planning and the effectuation of consent (together,

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28. Macneil, *Relational Contract Theory*, *supra* note 12, at 879–80 (citing Ian R. Macneil, *Values in Contract: Internal and External*, 78 NW. L. REV. 340, 347 (1983)). Finally, to turn factual description into theory, Macneil identified four “core propositions” with which any theory of relational contract must be defined:

First, every transaction is embedded in complex relations.

Second, understanding any transaction requires understanding all essential elements of its enveloping transactions.

Third, effective analysis of any transaction requires recognition and consideration of all essential elements of its enveloping relations that might affect the transaction significantly.

Fourth, combined contextual analysis of relations and transactions is more efficient and produces a more complete and sure final analytical product than does commencing with non-contextual analysis of transactions.

*Id.* at 881 (footnotes omitted).

29. *Id.* at 879 (writing that while he did not set out to create a theory, he had to concede that “[s]ince repeated human behavior invariably creates norms, these behavioral categories are also normative categories”).

30. Macneil, *Values in Contract*, *supra* note 22, at 351–52. For the business social science interpretation of this point, and perhaps the earliest study operationalizing Macneil’s relational norms, see Patrick J. Kaufmann & Louis W. Stern, *Relational Exchange Norms, Perceptions of Unfairness, and Retained Hostility in Commercial Litigation*, 32 J. CONFLICT RESOL. 534, 535 (1988) (“According to Macneil, types of commercial exchange form a continuum from purely discrete transactions . . . to relational exchange . . . . What distinguishes between discrete and relational exchange is the way general contracting norms are manifested in the parties’ relationship. Three of the most important general contracting norms are solidarity, role integrity, and mutuality. In one form or another they exist in all exchange behavior, from the very discrete to highly relational exchange.”).

31. Macneil, *Relational Contract Theory*, *supra* note 12, at 894–97.

32. Although there is some discussion in the literature about whether this is what Macneil actually meant, Catherine Mitchell has also made this observation. Catherine Mitchell, *Contracts and Contract Law: Challenging the Distinction Between the ‘Real’ and the ‘Paper’ Deal*, 29 OXFORD J. LEGAL STUD. 675, 680–81 (2009).

“presentation”).<sup>33</sup> The more intense these behaviors are, and the less intense the others, the closer to the discrete end of the spectrum that contract falls. By contrast, the (relatively) more relational engagements tend to be characterized by what he called “the relational norms,” by which he meant “intensifications” of the more relational of the ten common contract norms.<sup>34</sup> All contracts have some relational aspect to them, whether minimal, and thus falling on the discrete end of the spectrum, or dominant, thus falling on the relational end.<sup>35</sup> As will be shown *infra*, the business social science research confirms the existence of both the common contract norms and the contracting spectrum, essentially proving the descriptive hypotheses at the normative center of relational contract theory.<sup>36</sup>

In sum, while the normative framework of a typical legal theory is a single value, such as efficiency or autonomy, relational contract theory’s normative framework is the product of observation. Exchange behavior includes some combination of the ten common contract norms, containing at minimum solidarity and reciprocity, and all contracts fall somewhere on the discrete-relational spectrum. Relational contract theory is not a body of law organized around some familiar normative value and applicable to relational contracts, but rather, as one author helpfully observed, it “reveal[s] the relational [aspect] of *all* contracts.”<sup>37</sup> Moreover, as Macneil repeatedly stressed, relational

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33. Macneil, *Values in Contract*, *supra* note 22, at 349 (defining the “discrete norm” as “discreteness and presentation,” which he explains results from the intensification of two of the common contract norms (implementation of planning and effectuation of consent)). Notably, to avoid being misunderstood as saying there were different “kinds” of contracts (some discrete, and some not), commentators have pointed out that he later renamed the “discrete” end of the spectrum the “as-if-discrete,” insisting that all contracts are, to some degree, relational. *See, e.g.*, Peter Vincent-Jones, *The Reception of Ian Macneil’s Work on Contract in the U.K.*, in *THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL* 67, 68 (David Campbell ed., 2001).

34. Macneil, *Values in Contract*, *supra* note 22, at 350 (“The relational norms of role integrity, preservation of the relation, harmonization of relational conflict, and supracontract norms are also intensifications of particular common contract norms. These are primarily role integrity, contractual solidarity, and harmonization with the social matrix.” (footnote omitted)).

35. Ian R. Macneil, *Relational Contract: What We Do and Do Not Know*, 1985 *WIS. L. REV.* 483, 485, 489–90 [hereinafter Macneil, *Relational Contract*] (noting that all production, even the most discrete, is embedded within relations, and so declaring that “[b]ecause of the limited nature of this [discrete production] function and because it can be and is also carried on by relational exchange, discrete exchange is always rare compared to relational exchange”).

36. *See* discussion *infra* Section III.B and accompanying notes.

37. Smith & King, *supra* note 10, at 9 & n.48 (quoting David Campbell, *Ian Macneil and the Relational Theory of Contract*, in *THE RELATIONAL THEORY OF CONTRACT: SELECTED WORKS OF IAN MACNEIL* 3, 5 (David Campbell ed., 2001)) (making the distinction that “[t]his is not a *theory of relational contracts*, but rather a *relational theory of contracts*. The difference is intended to suggest that “[a]ll exchange occurs in relations.” (second alteration in original)).

contract theory is value neutral.<sup>38</sup> This is important because, as the next subsection discusses, terms like reciprocity and cooperation tend to suggest a bias toward judicial intervention. But as with the norms themselves, Macneil's observations about the cooperative aspects of human nature are only normative to the extent that they are descriptively accurate.

B. *Relational Contract Theory Accounts for Both Competition and Cooperation in Exchange*

Relational contract theory takes it as a given that all exchange is both competitive and cooperative. In this respect, exchange is unavoidably dualistic. Macneil explained that exchange is unavoidably dualistic because human nature is dualistic.<sup>39</sup> Of our dual nature, he wrote, "As students of man in society, we are faced with an illogicality. Man is both an entirely selfish creature and an entirely social creature, in that man puts the interest of his fellows ahead of his own interests *at the same time* that he puts his own interests first."<sup>40</sup> He continued, "Such a creature is schizophrenic, and will, to the extent that it does anything except vibrate in utter frustration, constantly alternate between inconsistent behaviors—selfish one second and self-sacrificing the next. Man is, in the most fundamental sense of the word, irrational . . . ."<sup>41</sup>

Our rational-irrational nature is present in all contracting relationships, but it manifests most clearly in two of the ten common contract norms. They are solidarity ("the norm that holds exchanges together"<sup>42</sup>) and reciprocity (or "mutuality"<sup>43</sup>). As noted, these behav-

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38. Macneil, *Values in Contract*, *supra* note 22, at 401 (observing that, except to the extent that the common contracting norms have value as accurate descriptions of common contracting behaviors, relational contract theory is otherwise a "neutral" theory and should not be misunderstood as "presumptively supporting great sovereign intervention").

39. *Id.* at 348. For a more detailed discussion of duality, see Ian R. Macneil, *Exchange Revisited: Individual Utility and Social Solidarity*, 96 ETHICS 567, 569 (1986). Macneil argued that the human economic actor has two sides to her: because she is human, she is both selfish and other-regarding at the same time. This means that any contracting actor is capable of, at one time, acting from a place of complex motivations, incorporating aspects of both a selfish actor (the classical notion of economic self-interest, or "economic man") and also an other-regarding actor (the sociological notion of "social man"). Macneil, *Values in Contract*, *supra* note 22, at 348.

40. Macneil, *Values in Contract*, *supra* note 22, at 348 (footnote omitted).

41. *Id.* Others have commented upon this passage as well. See, e.g., Mitchell, *supra* note 32, at 687 ("Macneil regards this dualism as a reflection of human nature."); Melvin A. Eisenberg, *Why There Is No Law of Relational Contracts*, 94 NW. U. L. REV. 805, 813 (2000) (quoting the same passage by Macneil); Sarah Maxwell, *The Social Norms of Discrete Consumer Exchange: Classification and Quantification*, 58 AM. J. ECON. & SOC. 999, 1003 (1999) ("As Macneil commented, 'Humans are—cannot otherwise be—inconsistently selfish and socially committed at the same time.'" (citation omitted)).

42. Kaufmann & Stern, *supra* note 30, at 535 (citing Ian R. Macneil, THE NEW SOCIAL CONTRACT 52 (1980)).

iors characterize all contracts.<sup>44</sup> For that reason, Macneil thought that reciprocity and solidarity merited special attention.<sup>45</sup> He wrote:

Two principles of behavior are essential to the survival of such a creature: solidarity and reciprocity. Man, being a choosing creature, is easily capable of paralysis of decision when two conflicting desires are in equipoise. The two principles of solidarity and reciprocity, neither of which can operate through time without the other, solve this problem. Getting something back for something given neatly releases, or at least reduces, the tension in a creature desiring to be both selfish and social at the same time, and solidarity—a belief in being able to depend on another—permits the projection of reciprocity through time.<sup>46</sup>

The special function of solidarity and reciprocity captures another distinctive nature of relational contract theory, which is that the institution of contract is not amenable to categorization according to a single metric, such as competitive *or* cooperative. Instead, like the contracting actor, the institution of contract is inherently dualistic. It is a socio-economic institution, not a social *or* economic institution. And, as will be shown *infra*, marketing and management researchers adjusted their transaction cost economics models to include relational norms precisely because of contract's dual nature.<sup>47</sup>

Before moving to Part III, however, it is worth pausing to note an important cause of misunderstanding about relational contract theory. It is a mistake to conflate relational with altruistic. In this context, relational means the tendency toward both cooperation and competition. An economic actor can and will be both pro-social (cooperative) and anti-social (opportunistic). That this aspect of relational theory is misunderstood is somewhat ironic. Under strict rational choice theory, an economic actor is hyper-rational, meaning that actor would never act opportunistically.<sup>48</sup> Yet somehow, we have come to associate relational contract with cooperative tendencies, and economic analysis with competitive tendencies. According to relational contract theory, however, an economic actor cannot help but have both tendencies. In the next Part, the Article shows how organization theory, marketing, and strategic management scholars operationalized this insight to better the predictive power of transaction cost economics research.

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43. See, e.g., *id.* at 536 (“Macneil . . . suggests that the norm of mutuality, while not requiring equality in the division of the exchange surplus, requires an ‘even’ distribution that assures adequate returns to each.” (citing Ian R. Macneil, *THE NEW SOCIAL CONTRACT* 44 (1980))).

44. See *id.* at 535.

45. Macneil, *Values in Contract*, *supra* note 22, at 348.

46. *Id.* at 348–49 (footnotes omitted).

47. See *infra* Sections III.A–B.

48. See Williamson, *The Economics of Organization*, *supra* note 5, at 554 (noting that, consistent with the goal of parsimony, the traditional orthodox economic assumption of hyper-rationality did not allow for such deviance).

## III. RELATIONAL BEHAVIORS OPERATIONALIZED

Although relational contract theory was developed in legal scholarship, relational contract norms have been employed more thoroughly in business social science scholarship and, specifically, in marketing and strategic management work.<sup>49</sup> This Part shows how business scholars have led the way in economically operationalizing relational contract principles using the tools of transaction cost economics.<sup>50</sup> These scholars have gone beyond simply accepting the descriptive insights of relational theory to incorporating relational norms into data collection and analysis. This research is important both for what it says and the potential it represents. It suggests that contract scholars could learn a great deal about the economic effects of relational contract behaviors across industries and commercial subgroups, parsed by transaction structure, environment, and other institutional variables. Remarkably, these studies have largely not surfaced in legal literature.<sup>51</sup>

This Part will offer an illustrative sample of this research to confirm how important relational norms are in modern transactions and,

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49. There are exceptions. See, for example, Mitchell, *supra* note 32, in which the author reviews business organizations and strategic management literature citing Macneil—including some of the same studies I reviewed for this Article—and discusses how those studies challenge the notion (familiar in contract law) that there is a sharp distinction between the “real” deal (the informal terms firms abide by) and the “paper” deal (the written, formal contract terms). And interestingly, Macneil himself observed that his insights were incorporated by TCE analysts, and commented on the both the underlying similarities and differences between transaction cost analysis and relational contract theory analysis. He concluded that “transaction cost analysis adheres in considerable measure, but by no means entirely,” to the relational contract theory proposition that “it is both more efficient and more sure to engage in combined contextual analysis of relations and transactions than to commence with non-contextual analysis of transactions.” Macneil, *Relational Contract Theory*, *supra* note 12, at 891.

50. As will be shown *infra*, once one understands Macneil’s conception of contract, this makes perfect sense. Briefly, by explicitly citing and following Macneil’s concept of contractual norms, these scholars have accepted Macneil’s view that the “fundamental unit of . . . contract” is simultaneously competitive *and* cooperative; thus, the parties to a contract are one maximizing unit. Campbell, *Ian Macneil and the Relational Theory of Contract*, *supra* note 13, at 14.

51. I am not the first to press contract scholars to mine this abundant trove of data. As George Geis argued fifteen years ago:

The case for using marketing research in contract law scholarship is straightforward. Contract theory, on one hand, needs empirical data to test a variety of claims. Marketing scholars, on the other hand, have conducted vast amounts of empirical research over the past several decades. In some cases, this research may address the same questions being asked in contract law.

George S. Geis, *Empirically Assessing Hadley v. Baxendale*, 32 FLA. ST. U. L. REV. 897, 952 (2005) (footnotes omitted). He concluded that, most likely, “broader use of marketing research can address other perceived dead ends in contract law theory.” *Id.* at 956. Further, as noted *supra*, Catherine Mitchell also made this observation previously. See Mitchell, *supra* note 32, at 704.

equally importantly, to provide a sense of what else might be learnable with further study. This Part first provides the unfamiliar reader with more information on transaction cost economics, including how it differs from neoclassical economics (Section A). Then the Article discusses illustrative TCE studies modeling for relational behaviors. I start with the reciprocity norms, which are tested as the norms of flexibility and information exchange (Section B), and then move to contractual solidarity, expressed as trust and prior relational ties (Section C).

A. *Transaction Cost Economics and Its Home in the New Institutional Economics*

Transaction cost economics is a part of a bigger economic movement called the New Institutional Economics (“NIE”). Nobel Laureate economist Oliver Williamson coined the phrase NIE in the 1970s,<sup>52</sup> though the ideas that generated the field are largely attributed to Ronald Coase.<sup>53</sup> While both NIE and neoclassical economics assume the normative value of efficiency, they differ significantly.<sup>54</sup> Probably the most fundamental difference between NIE and traditional economics is that NIE accounts for transaction costs,<sup>55</sup> whereas older-style traditional economics assumes them away.<sup>56</sup>

On a more granular level, mainstream neoclassical economics and NIE ask different questions, and they use different tools to analyze data. While mainstream neoclassical economics seeks to explain choices of consumers and firms, NIE seeks to explain organizations.<sup>57</sup>

52. Ronald Coase, *The New Institutional Economics*, 88 AM. ECON. REV. 72, 72 (1998). For a history of institutional economics, and a comparison with modern work, see Malcolm Rutherford, *Institutional Economics: Then and Now*, 15 J. ECON. PERSP. 173, 187 (2001) (describing as one effect of the recent “revival of interest in institution[alism]” the “development [of] what has become known as the ‘new institutional economics,’ consisting in large part of transaction cost analysis of property rights, contracts and organizations,” and noting that “[t]his new institutional economics has generally identified itself as an attempt to extend the range of neoclassical theory by explaining institutional factors traditionally taken as givens, . . . and, unlike the old institutionalism, not as an attempt to replace the standard theory”).

53. Specifically, to Coase’s 1937 *The Nature of the Firm*. See Oliver E. Williamson, *Revisiting Legal Realism: The Law, Economics, and Organization Perspective*, 5 INDUS. & CORP. CHANGE 383, 387–88 (1996) [hereinafter Williamson, *Revisiting Legal Realism*].

54. See Jan B. Heide & George John, *Do Norms Matter in Marketing Relationships?*, 56 J. MARKETING 32, 33 (1992) (“TCA is an analytical paradigm whose primary subject matter is the design of efficient governance mechanisms for supporting exchange.”).

55. FURUBOTN & RICHTER, *supra* note 5, at 34.

56. *Id.* at 47.

57. In this way, traditional microeconomics is a “science of choice,” whereas NIE is a “science of contract.” Oliver E. Williamson, *The Theory of the Firm as Governance Structure: From Choice to Contract*, 16 J. ECON. PERSP. 171, 172 (2002) (explaining broadly that mainstream economics is a “science of choice”—of consumers, to maximize utility, and of the firm as a “production function,” to maximize profit,

Each has its own analytical framework, or, in other words, each has its own set of tools to operationalize its approach. Mainstream neoclassical economics primarily uses rational choice theory.<sup>58</sup> NIE primarily uses TCE. That said, in the most recent generation of law and economics scholarship, the approaches have begun to converge on the problem of incomplete contracting. Incomplete contracting, at least theoretically, cannot happen under a pure neoclassical economic paradigm.

Transaction cost economics is so-called because its goal is to predict the most efficient transactional structure of inter-firm bilateral exchange given the presence of transaction costs.<sup>59</sup> Oliver Williamson initially developed the TCE approach to analyze the paradigmatic make or buy question, which is: when a good or service is needed, should a firm contract on the market to acquire what is needed (buy) or acquire the capability (such as through vertical integration with another firm) to produce it in-house (make)?<sup>60</sup> Traditional economics did not ask this question given the assumption of perfectly competitive markets. While TCE predicts that simple spot-market purchasing is cheapest, TCE also predicts that the presence of various contracting hazards can make market exchange too expensive, causing a firm to consider vertical integration<sup>61</sup> or to spend on other contractual safeguards.<sup>62</sup> Vertical integration does not have to be total acquisition. Instead, it includes many middle-space forms, called quasi-integration, where the contracting partners remain independent though are signifi-

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whereas NIE arose as a “science of contract”—how firms govern their exchange relationships with other firms). And traditional economics assumes contracts are complete upon formation; NIE/TCE assumes they are incomplete and the analysis focuses on *ex post* governance. Williamson, *Revisiting Legal Realism*, *supra* note 53, at 386.

58. Rational choice is a function of modeling the market as an optimal allocation of goods at general competitive equilibrium. *See, e.g.*, David Campbell, Commentary, *The Incompleteness of Our Understanding of the Law and Economics of Relational Contract*, 2004 WIS. L. REV. 645, 646 (reviewing Juliet P. Kostritsky, *Taxonomy for Justifying Legal Intervention in an Imperfect World: What to Do When Parties Have Not Achieved Bargains or Have Drafted Incomplete Contracts*, 2004 WIS. L. REV. 323).

59. Oliver E. Williamson, *Transaction Cost Economics Meets Posnerian Law and Economics*, 149 J. INSTITUTIONAL & THEORETICAL ECON. 99, 101 (1993) (“Transaction cost economics is intendedly responsive to the Coasian imperative: study the world of positive transaction costs.”).

60. Williamson initially developed the tool of TCE in order to analyze the paradigmatic “make or buy” question: when a good or service is needed, should a firm contract on the market to buy what is needed or acquire the capability to produce it in-house? *See, e.g.*, George S. Geis, *An Empirical Examination of Business Outsourcing Transactions*, 96 VA. L. REV. 241, 244–45 (2010).

61. *Id.* at 244.

62. Robert C. Fink et al., *Transaction Cost Economics, Resource Dependence Theory, and Customer-Supplier Relationships*, 15 INDUS. & CORP. CHANGE 497, 499 (2006); *cf.* Ronald J. Gilson et al., *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 55 (2014) (identifying both the level of contracting uncertainty and the “thickness” of the market as two important background variables driving contract design decisions).



cantly more intertwined than the traditional discrete models assumed.<sup>63</sup> Negotiating quasi-integration arrangements is an additional source of transaction costs.

Another notable difference between TCE and more traditional economic analysis is that TCE relaxes the assumption that economic actors are hyper-rational.<sup>64</sup> In its place, TCE assumes bounded rationality, which then becomes another source of transaction costs.<sup>65</sup> Consequently, TCE assumes that organizational man is “motivationally . . . complex,” differentiating him from hyper-rational economic man, who always “plays by the rules.” Organizational-economic man’s motivational complexity creates the possibility of opportunistic behavior.<sup>66</sup> Controlling for opportunism then becomes another source of transaction costs.<sup>67</sup> Indeed, because this literature takes on opportu-

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63. See, e.g., Jan B. Heide, *Interorganizational Governance in Marketing Channels*, 58 J. MARKETING 71, 71 (1994) (“There has been a resurgence of research and theorizing about interfirm relationships in the marketing literature. The trends described more than ten years ago by Arndt (1979) as ‘market domestication’ are becoming increasingly evident, in the form of the emergence of vertical marketing systems, closer buyer-seller relationships and increasing growth in ‘partnerships’ and other forms of interfirm alliances. Theoretically, these trends imply that the traditional spot market, to an increasing extent, is being supplanted with alternative mechanisms for governing exchange. From a managerial perspective, they imply that the design of interfirm relationships is becoming a strategic decision variable in its own right.” (citations omitted)); Jan B. Heide & George John, *Alliances in Industrial Purchasing: The Determinants of Joint Action in Buyer-Seller Relationships*, 27 J. MARKETING RES. 24, 24 (1990) (describing in the abstract that “recent trends in industrial markets indicated that buyers and sellers are increasingly supplanting conventional ‘arms-length’ arrangements with ‘alliances’ involving closer ties,” and noting that their project was to “develop a theoretical model of industrial buyer-supplier ties that presents joint action as a key aspect of closeness”); Williamson, *Revisiting Legal Realism*, *supra* note 53, at 393.

64. See, e.g., FURUBOTN & RICHTER, *supra* note 5, at 47; see also Williamson, *The Economics of Organization*, *supra* note 5, at 553–54 (drawing a distinction between the purely rational actor, a/k/a “economic man,” who exists only in theory, and “organizational man,” who operates in the real world, and who is “boundedly rational,” though not irrational). Consistent with the goal of parsimony, the traditional orthodox assumption of hyper-rationality does not allow for such deviance. *Id.* at 554 (defining opportunism as “self-interest seeking with guile”); *id.* at 554 n.9 (“[S]tandard economic models . . . [treat] individuals as playing a game with fixed rules which they obey. They do not buy more than they can pay for, they do not embezzle funds, and they do not rob banks.” (alteration in original) (quoting Peter Diamond, *Political and Economic Evaluations of Social Effects and Externalities: Comment*, in *FRONTIERS OF QUANTITATIVE ECONOMICS* 31 (Michael D. Intriligator ed., 1971))).

65. Bounded rationality is a source of transaction costs. As an interesting aside, in writing about Oliver Williamson and transaction cost economics, Macneil observed that, to the extent that TCE does not follow rational choice theory, it “is not economics at all. It is straightforward, untheoretical empiricism, determining as a matter of existential fact just what the costs are of exchanging things of value in particular ways—sociology. Perish the thought! But it happens to be true.” Macneil, *Relational Contract Theory*, *supra* note 12, at 890 n.48.

66. Williamson, *The Economics of Organization*, *supra* note 5, at 554.

67. *Id.* Thus, the TCE approach requires the analyst to consider the costs arising out of the need to observe and/or control for opportunism, including the costs of negotiating, monitoring, and enforcing contracts. See, e.g., Ranjay Gulati, *Does Famil-*

nism directly, it contains a rich set of data showing how contractors control for opportunism in different situations.<sup>68</sup>

Opportunism is notoriously difficult to pin down, but in the business literature, TCE scholars tend to follow Oliver Williamson's definition of "self-interest seeking with guile."<sup>69</sup> One TCE study characterizes opportunism as "aggressive selfishness" that "disregards the impact of a firm's actions on others."<sup>70</sup> Contract law literature also suggests varying definitions, but several key scholars follow Williamson and define opportunism as "a transfer of wealth from one party to another at the other's expense."<sup>71</sup> As noted, before the late 1980s and early 1990s, opportunism was the only behavioral norm assumed by transaction cost economics.<sup>72</sup> But around that time, suspecting that they could measure relational norms' transaction cost effects, some institu-

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*ilarity Breed Trust? The Implications of Repeated Ties for Contractual Choice in Alliances*, 38 ACAD. MGMT. J. 85, 86 (1995).

68. Interestingly, opportunism is a presumption that is shared by relational theory and transaction cost economics, but not classic rational choice theory. *See, e.g.*, Richard E. Speidel, *Article 2 and Relational Sales Contracts*, 26 LOY. L.A. L. REV. 789, 795 (1993) ("Both relationalists and transaction-cost economists recognize the importance of preventing opportunism in relational contracts. Opportunism rears its ugly head when one party departs from the internally generated norms of the relationship . . . . If the contract does not have a governance structure to regulate or define opportunism [which is a chief object of transaction-cost analysis], or if that structure fails and the parties cannot agree, a court may be asked to intervene. . . . More particularly, the question is whether the allegedly opportunistic conduct is permitted or constitutes a 'breach' of the relational contract.").

69. Timothy G. Hawkins et al., *Antecedents and Consequences of Opportunism in Buyer-Supplier Relations: Research Synthesis and New Frontiers*, 37 INDUS. MARKETING MGMT. 895, 895 (2008).

70. *Id.* ("Opportunism . . . includes such activities as stealing, cheating, breach of contract, dishonestly, distorting data, obfuscating issues, confusing transactions, false threats and promises, cutting corners, cover ups, disguising attributes or preferences, withholding information, deception, and misrepresentation . . . .").

71. *See, e.g.*, Timothy J. Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521, 521 (1981) (describing opportunistic behavior as occurring when, "a performing party behaves contrary to the other party's understanding of their contract, but not necessarily contrary to the agreement's explicit terms, leading to a transfer of wealth from the other party to the performer—a phenomenon that has come to be known as opportunistic behavior" (citing OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975); Benjamin Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV. 356 (1980); Benjamin Klein et al., *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297 (1978); Benjamin Klein & Keith B. Leffler, *Market Enforcement of Contracts: The Role of Price in Guaranteeing Quality*, 89 J. POL. ECON. 615 (1981); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & ECON. 233 (1979); Oliver E. Williamson et al., *Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange*, 6 BELL J. ECON. 250 (1975)); *cf.* Richard A. Posner, *Fundamental Principles of Contract Damages*, in *ECONOMIC ANALYSIS OF LAW* 128 (9th ed. 2014) (identifying exploitation of bilateral monopoly situation as opportunism).

72. Heide & John, *supra* note 54, at 32.

tionally minded marketing and strategic management scholars began to incorporate other relational norms into their research.<sup>73</sup>

That relational contracting norms may disincentivize opportunistic conduct is important because it suggests that contractors may take relational norms more seriously than contract law scholars previously assumed.<sup>74</sup> If contractors economically value bilateral (shared) relational norms because they deter opportunism, contractors might expect that a disappointed relational economic expectation would be treated in the law like any other disappointed economic expectation. Or, if contractors see a disappointed relational expectation as evidence of economic opportunism, then perhaps the law should too—despite the fact that contract law has so far mostly considered such expectations as largely irrelevant.<sup>75</sup>

#### B. *Modeling Cooperative Norms and Their Effects on Opportunism*

Because of Macneil's influence, first on Williamson and then on others, TCE scholars began testing whether relational contract norms disincentivize opportunism. The first influential study in this work was Jan Heide and George John's study, *Do Norms Matter in Marketing Relationships?*, which examined the role of relational norms as deterrents to opportunism in industrial buyer-seller relationships.<sup>76</sup> Prior to that study, when one independent firm had specialized assets at risk in a transaction with another independent firm, standard TCE wisdom was that the more vulnerable firm should try to acquire some kind of control over their partner, either by acquisition, or by quasi-integration, meaning the ability to exercise decision-making control over deal

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73. Interestingly, the very first business social science study to "operationalize" Macneil's relational contract norms was conducted by Patrick J. Kaufmann. See Kaufmann & Stern, *supra* note 30, at 544–45, 545 n.13.

74. See, e.g., Posner, *Fundamental Principles of Contract Damages*, *supra* note 71, at 129 ("It makes a difference in deciding which remedy to grant whether the breach was opportunistic [in that, when a breach is opportunistic], we might as well throw the book at him."). An exception could be if the parties agreed to accept opportunistic conduct from each other, such that "opportunistic conduct" became a "norm" of the relationship. If that were the case, however, one would not expect any cooperative relational norms shared as mutual expectations in that relationship. Thus, without strong cooperative relational norms, there could be no relational expectations to be "breached" in an act of "opportunistic conduct."

75. As will be set out *infra*, I am not arguing that a relational norm becomes enforceable as a stand-alone "term." Instead, the argument is that relational norms, at the point they are relied upon to curb opportunism, may be relevant to give content to otherwise content-less and vague commercial law standards, such as good faith. See discussion *infra* Section VI.B. It should be noted that the argument here also speaks to the verifiability problem of gap-filling in incomplete contracting, which is identified and discussed in the economics literature. For a primer, see Benjamin E. Hermalin et al., *Contract Law*, in 2 THE HANDBOOK OF LAW AND ECONOMICS 68–69 (A. Mitchell Polinsky & Steven Shavell eds., 2007) (explaining the economic concepts of "observable" and "verifiable" in the incomplete contracting literature).

76. Heide & John, *supra* note 54, at 34.

decisions.<sup>77</sup> The authors noted, however, that scholars did not understand what conditions would enable one independent firm to cede decision-making control to another.<sup>78</sup> The authors suspected that relational norms, as identified by Macneil, might have something to do with it.<sup>79</sup>

To figure that out, the authors studied how a buyer might gain decision-making control over a supplier.<sup>80</sup> In that setting, a buyer could ask the seller for final say on certain production-related decisions, such as who the component manufacturers would be, or what the time of production and delivery would be.<sup>81</sup> However, where the buyer had asset-specific investments at risk, the buyer had no power to exact these concessions. The authors observed that, despite the buyer's relative vulnerability in this situation, sellers cede power to buyers in quasi-integration deals all the time. Why? Under what conditions would a seller cede control to the buyer, even though the seller was in the more powerful position?<sup>82</sup>

The authors hypothesized that the party asked to give up control (here, the seller) would not do so unless that party was assured that the control would not be abused (by the buyer).<sup>83</sup> The authors further hypothesized that, in order for the seller to agree to transfer decision-making control to the buyer, the parties would need to sufficiently trust each other in the first place.<sup>84</sup> If they did not, the deal probably

77. *Id.* at 33.

78. *Id.* But see Hawkins et al., *supra* note 69, at 903, 905 (reviewing literature finding that relational norms are “phenomena that can mitigate opportunism,” including Heide & John, *supra* note 54, but then theorizing that opportunism itself may be a norm in some exchange relationships, and calling for new empirical study to confirm or refute this hypothesis under varying contracting conditions).

79. Heide & John, *supra* note 54, at 33.

80. *Id.* at 34.

81. *Id.* at 34–35.

82. *Id.* at 33.

83. *Id.* This assertion continues to have purchase in ongoing marketing/management research. See, e.g., Yi Liu et al., *How Does Justice Matter in Achieving Buyer-Supplier Relationship Performance?*, 30 J. OPERATIONS MGMT. 355 (2012). In that piece, the authors began from the premise that “social facets [of long term contractual relationship management] complement the structural.” *Id.* at 356. The authors then hypothesized that a high level of mutual justice perceptions in buyer-seller relationships promotes coupling between buyer and seller, whereas “coupling” referred to specific “coupling behaviors,” including “knowledge sharing,” “continuous commitment,” and “relationship investment.” *Id.* at 357–58. The authors concluded:

Through an analysis of 216 manufacturer-distributor dyads in China, we find that a higher level of justice mutually perceived by two parties is positively associated with higher levels of coupling behaviors devoted to supply chain activities by both parties. In turn, higher levels of mutual coupling behaviors contribute to the relationship performance of the dyad.

*Id.* at 364. One managerial implication is that (mutual) perceptions of justice drive relationship performance. *Id.* at 364–65.

84. Heide & John, *supra* note 54, at 33 (“[An inter-firm exchange transaction] is feasible only if the other party has the confidence that relinquishing control will not create a condition of vulnerability.”).

would not get done.<sup>85</sup> As such, the authors tested not whether relational norms functioned as rules of the relationship, but whether relational norms created the conditions for the supplier to cede control to the buyer.<sup>86</sup>

The study tested for shared expectations of three relational norms: flexibility, information exchange, and solidarity.<sup>87</sup> First, as to the norm of flexibility, the authors asked survey respondents to indicate their agreement or disagreement with the following prompts:

- Flexibility in response to a request for changes is a characteristic of this relationship.
- The parties expect to be able to make adjustments in the ongoing relationship to cope with changing circumstances.
- When some unexpected situation arises, the parties would rather work out a new deal than hold each other to the original terms.<sup>88</sup>

Second, as to the norm of information exchange:

- In this relationship, it is expected that any information that might help the other party will be provided to them.
- Exchange of information in this relationship takes place frequently and informally, and not only according to a prespecified agreement.
- It is expected that the parties will provide proprietary information if it can help the other party.
- It is expected that we keep each other informed about events or changes that may affect the other party.<sup>89</sup>

And third, as to the norm of solidarity:

- Problems that arise in the course of this relationship are treated by the parties as joint rather than individual responsibilities.
- The parties are committed to improvements that may benefit the relationship as a whole, and not only the individual parties.
- The parties in this relationship do not mind owing each other favors.<sup>90</sup>

The data confirmed the existence of relational norms as well as the function the norms served in those relationships.<sup>91</sup> Specifically, the data showed that parties who agreed to cede control did so only when each was confident that, as “bilateral [i.e., shared] expectations,” the

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85. *See id.*

86. *Id.* (“[W]e do not have an understanding of the conditions that enable a firm to establish vertical control in relationships between independent firms.”).

87. *Id.* at 37 (testing for shared expectations on both sides of the buyer-seller dyad).

88. *Id.* & tbl.1. Participants were asked to note their level of agreement on a seven point scale: completely inaccurate description to completely accurate description.

89. *Id.*

90. *Id.*

91. *Id.* at 39 (finding that “the correlations between the buyer and supplier informants for the 60 cases in which dyadic data were obtained . . . are significant and positive”).

other would respect the three reciprocity norms of flexibility, information exchange, and solidarity.<sup>92</sup> Indeed, the authors also concluded that the firms' commitments to these relational norms probably made the transaction possible in the first place, as well as more efficient in the end.<sup>93</sup> The authors therefore concluded that in some situations, the pursuit of cooperation could lead more directly to a better result than could the pursuit of control:

Contrary to the notion that control is desirable *per se*, firms should structure relationships in a discriminating way, based on the characteristics of the situation in question. Firms should not pursue control as a goal in its own right, but only attempt to acquire control when specific assets are at risk. From the other side, it is not always wrong to cede control. The key is to be protected against abuse of control, and relational norms can serve that purpose. Hence supportive norms have significant economic value when specific assets need to be safeguarded.<sup>94</sup>

This is a remarkable conclusion because before this study, transaction cost analysis routinely predicted that firms should pursue control, not cooperation.<sup>95</sup> TCE had routinely predicted the control strategy because, as noted, TCE assumes opportunistic behavior.<sup>96</sup> Given opportunism, TCE predicted that optimal outcomes required the competitive pursuit of control by each party to the exchange. That prediction fundamentally changed as a result of this study's findings on the role of relational norms.

The results of this study are also significant because they suggest that relational expectations are also economic expectations, which in turn suggests that contractors may have a broader idea of what constitutes opportunism (a transfer of wealth from one party to another at that party's expense) than we knew. If firms rely on relational norms in part to control partner opportunism, and if relational norms under certain conditions do enhance the overall profitability of the exchange, then those firms may well consider relational expectations as

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92. *Id.* at 37, 41–42.

93. *Id.*; see also Sarah Maxwell, *The Social Norms of Discrete Consumer Exchange: Classification and Quantification*, 58 AM. J. ECON. & SOC. 999, 1002 (1999) (finding that “relational exchange norms have been shown to have a significant effect on inter-firm economic transactions,” and citing Doug Ayres et al., *An Exploratory Investigation of Organizational Antecedents to New Product Success*, 34 J. MARKETING RES. 107 (1997) (showing “the significant negative effect of the relational norms of flexibility, solidarity, and conflict harmonization on new product success”); and Gregory Gundlach et al., *The Structure of Commitment in Exchange*, 59 J. MARKETING 78 (1995) (finding “five of the relational norms to be key variables in mediating long-term commitment: role integrity, mutuality, flexibility, solidarity and harmonization of conflict”).

94. Heide & John, *supra* note 54, at 41–42.

95. *Id.* at 33.

96. Williamson, *Transaction Cost Economics Meets Posnerian Law and Economics*, *supra* note 59, at 109 (on the justification for the assumption of bounded rationality).

economic expectations. Usually we think that express terms set out the parties' economic expectations, while background relational expectations are merely informal grease for the wheel. But this research suggests that contractors see relational expectations as *economic* expectations.

For example, one conclusion of the Heide and John study was that a supplier would probably only agree to grant decision-making control over an aspect of its production process to an exchange partner if the supplier were confident that the buyer would not later abuse that control. Assume a buyer asks to be given approval rights over any distributors the supplier uses. Assume because of past deals together, the supplier is confident that this buyer is a trustworthy partner, and they do the new deal. But later, the buyer changes management. The buyer then tells the supplier it is prepared to withhold approval of a distributor the supplier prefers unless the supplier renegotiates another term in the buyer's favor. No express term obligates the buyer to agree. Yet it looks like the buyer is trying to exact a transfer of wealth at the supplier's expense—which is opportunism. The buyer's opportunistic action in that situation, while not a breach of an express term of the parties' contract, is inconsistent with expectations of contractual solidarity, and could be evidence of bad faith or commercial unreasonableness. Similarly, in these same conditions with different facts, the reverse could also be true. The absence of evidence showing the buyer tried to link a renegotiation decision over which it had been granted control by the supplier could negate a claim that the buyer was acting opportunistically. In short, this work suggests that because relational expectations can also be economic expectations, meeting or abusing those expectations in particular situations can be objective evidence of subjectively-held obligations like good faith.

A related research question permeating this literature is how informal governance mechanisms, such as relational norms, interact with express contract obligations. Scholars in both the organizational management literature and the contract law literature refer to this as the substitute or complement debate. Importantly, the debate presumes an either/or premise, which is either that informal controls (relational norms) coexist with formal controls (contract terms), such that the two forms of governance complement each other,<sup>97</sup> or alternatively, formal controls crowd out the interpersonal space needed for relational norms to develop, thereby causing a substitution effect. The substitution effect can play out one of two ways: either the written contract signals distrust and self-interest, thereby undermining rela-

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97. See, e.g., Laura Poppo & Todd Zenger, *Do Formal Contracts and Relational Governance Function as Substitutes or Complements?*, 23 STRATEGIC MGMT. J. 707, 721 (2002) (reviewing literature and proposing that, at least as to information services industry, the complementary view is more empirically accurate).

tional governance,<sup>98</sup> or the parties simply ignore the contract and work instead from common understandings.<sup>99</sup>

Catherine Mitchell argues that the *either* substitute *or* complement premise of the debate is overstated. She argues that the business social science literature on trust and contract shows that contractors often do not think of trust and contract as distinct phenomena, but rather as interactive, iterative phenomena. As such, she concludes that it is possible that trust and contract *neither* substitute *nor* complement each other.<sup>100</sup> As an illustration, Mitchell says that contractors may see their documents as performing “a variety of more nebulous functions designed to harness the trusting relationship and transform it into a more productive one.”<sup>101</sup> To empirically study a complex expectation like this, scholars must obtain relatively fine-grained data on the effects of combining formal and informal governance mechanisms. This work has indeed produced data at a more granular level than contract law scholars are used to seeing. Unlike Catherine Mitchell’s work, however, this Article does not undertake a comprehensive review of that literature in order to tease out trends. Instead, I intend only to give an example of what research like this can show.

One example is Canon, Achrol, and Gundlach, who, in *Contracts, Norms, and Plural Form Governance*, surveyed purchasing agents in various manufacturing industries to determine how, and under what conditions, they relied on informal and formal controls in contract relationships with suppliers.<sup>102</sup> The authors were particularly interested in the interaction between the different kinds of controls when con-

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98. See, e.g., Adam B. Badawi, *Relational Governance and Contract Damages: Evidence from Franchising*, 7 J. EMPIRICAL LEGAL STUD. 743, 744–46 (noting the conflict between the “substitute view” and the “complementary view,” and proposing that, at least with respect to franchising, the substitute view appears more accurate).

99. See, e.g., Macaulay, *supra* note 16, at 58–59. This is true at least until they can no longer do so and then require third party dispute resolution, such as a trade association or a court. See also Lisa Bernstein, *Opting out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 152–53 (1992) (finding that in the diamond industry, the contractors expressly opted out of U.C.C. Article 2 in favor of trade association dispute resolution, where they knew they could rely on the decision-makers to precisely follow the written terms of the contract).

100. While most scholars see formal and informal controls as “discrete” phenomena, and thus separately analyzable, a small number have begun to question the “either/or” nature of this debate. See, e.g., Mitchell, *supra* note 32, at 675, 684–94 (arguing that “a sharp distinction between the real and paper deal cannot be drawn and that in many commercial agreements these must be understood as integrated phenomena, rather than wholly discrete aspects of contracting behavior,” and reviewing business organizations and management literature in support).

101. *Id.* at 687.

102. Joseph P. Cannon et al., *Contracts, Norms, and Plural Form Governance*, 28 J. ACAD. MARKETING SCI. 180, 184–85 (2000) (noting that plural form governance is defined in the business literature as inter-firm governance incorporating elements of formal contract, or other controls based on authority, in tandem with relational norms or other informal controls).



tracts were one aspect of a broader contracting relationship.<sup>103</sup> The authors suspected that different combinations of controls would have different transaction cost effects based on different combinations of common contractual hazards.<sup>104</sup> To break it down, the authors assumed the hazard of relationship-specific investment<sup>105</sup> and then tested for the effects of that condition in combination with two other potential hazards and two sets of governance choices. The other potential hazards tested were market volatility (in the form of changing prices, product features, vendor support services, technology, and product availability) and task ambiguity (meaning that the product is difficult to evaluate; the product is known certainly to meet the buyer's needs; the supplier's performance can be difficult to evaluate objectively; and the product's performance can be easily evaluated).<sup>106</sup> The different kinds of governance mechanisms included "legal bonds"<sup>107</sup> and cooperative norms.<sup>108</sup> The research linked performance effects of particular combinations of hazards and controls with likely future governance choices.

The authors determined that while formal controls (contract) and informal controls (norms) generally lowered transaction costs when they were used in combination,<sup>109</sup> formal controls alone lowered costs *only* in one specific situation, which was when the exchange involved a low level of transactional uncertainty.<sup>110</sup> By contrast, the authors concluded that cooperative norms lowered costs regardless of the level of transactional uncertainty.<sup>111</sup>

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103. *Id.* at 191 (identifying as the object of study contracts "embedded within an identifiable relationship").

104. *Id.*

105. *Id.* at 186 tbl.1 (evaluating relationship-specific adaptations as high or low, and identifying the following possible adaptations: changing (1) product features; (2) personnel; (3) inventory and distribution; (4) marketing; and (5) capital equipment and tools).

106. *Id.* at 186 tbl.1, 187 ("The two exogenous conditions that were hypothesized to give rise to governance concerns were defined as relationship-specific adaptations in combination with two sources of transaction uncertainty, market dynamism and task ambiguity.").

107. *Id.* at 186 tbl.1 (identifying the following statements as items measuring legal bonds: (1) "We have specific, well-detailed agreements with this vendor"; (2) "We have formal agreements that detail the obligations of both parties"; and (3) "We have detailed contractual agreements with this supplier").

108. *Id.* at 184–85.

109. *Id.* at 191. When an exchange involved few relationship-specific adaptations and a low degree of transactional uncertainty, contracts were effective alone. *Id.* at 188–89 (conclusion on hypothesis 2). However, when an exchange involved more relationship-specific adaptations and a high degree of transactional uncertainty, increasing the specificity and detail of contracts did not enhance performance. *Id.* at 188 (conclusion on hypothesis 1). Further, under those same conditions, "increasing the relational content of the governance structure" did enhance performance. *Id.* at 189 (conclusion on hypothesis 3).

110. *Id.* at 191.

111. *Id.* at 189 (contradicting one of the authors' hypotheses—hypothesis 4—that "when there are few relationship-specific adaptations and low transaction uncertainty,

Cooperative norms have a positive effect . . . whether transactional environments are high in uncertainty or low. It seems because cooperative norms emphasize the shared values and mutual well-being of the parties, performance is enhanced regardless of the level of transactional uncertainty and regardless of the cost of developing and maintaining the norms.<sup>112</sup>

This study is notable for at least two reasons. First, it shows the level of detail TCE scholars generally are able to study. A study like this allows researchers to vary both the contracting conditions and the different mixes of controls in order to more precisely determine the cost-lowering effects of relational norms and contract terms, alone and in combination. Second, it shows that relational norms enhance contract performance even in the absence of specific contractual hazards. This particular conclusion may support Catherine Mitchell's integration thesis because it suggests a more complex interaction between formal and informal governance mechanisms than is captured by the substitute *or* complement debate.

Because this study found that relational norms enhance performance regardless of contracting hazards, it suggests that contractors have more incentive to develop relational norms than we might otherwise have expected. Incentives to develop relational norms, according to this study, are not limited to particularly troublesome environments. Instead, this conclusion suggests that relational norms may be an envelope in which the formal, and/or other informal, controls are nested. If this is true, it lends support to Mitchell's integration thesis—that relational norms neither substitute for nor complement formal controls. Instead, they may exist irrespective of the conditions needing to be controlled. If this is right, then work like this could have widespread implications.

### C. *Modeling for Background Social Context of Trust and Prior Relational Ties*

As the relational behaviors research expanded, TCE scholars became interested in whether and how preexisting trust between two firms affected the transaction costs of subsequent transactions between those firms. So, scholars began to look more closely at the parties' prior ties with each other. One of those scholars is organizational economist Ranjay Gulati, whose work in two different studies will be examined in this Section.

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increasing the relational content of the governance structure was predicted to not result in enhanced performance").

112. *Id.* at 191 ("[A] key contribution of the study has to do with the interaction of contracts and norms through plural form governance. . . . Overall, the results of our study have important theoretical and practical implications. Theoretically, they support the plural form argument that governance mechanisms such as contracts and social norms should be seen as building blocks of complex structures of governance and not as either/or alternatives.").

In the first study, Gulati tested whether parties with prior relational ties would prefer particular structural forms in their subsequent deals with each other.<sup>113</sup> The study started with the standard TCE baseline assumption that parties should prefer particular structural forms, and the driver of their preferences should be cost.<sup>114</sup> That is, TCE routinely predicted that the more expensive a deal became on the open market (“buy,” which is more discrete), the more likely the parties would be to compensate for those costs by choosing a more hierarchical, or integrated, transaction form (quasi-integration, which is more relational).<sup>115</sup> TCE standardly predicted that one significant variable driving costs (and so influencing selection of governance form) was the deal’s subject matter—some deals, like those for research and development (“R&D”), are just more expensive than others.<sup>116</sup> So, the authors asked whether, and if so, how, adding the variable of the parties’ prior relational ties to the TCE model would affect the model’s ability to predict the parties’ choice of governance form.<sup>117</sup> Specifically, in the context of the study, TCE standardly predicted that, whenever the subject of the deal was expensive joint R&D, the parties would try to control costs through a more relational structure, such as an equity alliance.<sup>118</sup>

The data showed that the standard prediction did not hold.<sup>119</sup> Specifically, the study found the opposite. The data showed that the *more* frequently two firms had previously engaged in equity-based alliances (more relational, and so, at least in theory, less expensive), the *less* likely they were to use the equity arrangement in the future, *even if* the subject of the agreement was still research and development.<sup>120</sup> This study found that the relational variable of prior ties did, in fact, change the parties’ preferred governance structure, but in the opposite manner as predicted.

Given this finding, the author concluded, first, that in this context, a model omitting a variable for prior relational ties would lack predictive power.<sup>121</sup> This finding is notable at the very least because, under

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113. Gulati, *supra* note 67, at 85–87 (such as the choice between a joint venture, licensing, direct investment, equity alliances, among others).

114. *Id.* at 87.

115. *See id.* at 87. Complicating matters is that in between these two poles are many other transactional forms, called “ally” structures, each of which involves some sort of control sharing arrangement between two independent firms, thus falling on the relational spectrum somewhere in between “buy” and “make.” *See id.*

116. *Id.* at 86.

117. *Id.*

118. *Id.* at 85–87.

119. *Id.* at 105.

120. *Id.*

121. Therefore, the study concluded that “transaction cost economics must explicitly incorporate the role of prior ties in its analytical framework. In particular, if the theory’s emphasis on the transaction as the appropriate unit of analysis is to remain viable, the interdependencies that result from prior transactions should be included.” *Id.* at 106.

traditional analysis, relational variables were thought to detract from, not add to, a model's predictive power.<sup>122</sup> Second, and more significantly, the study is an example of a deal "landing" on the more discrete end of the spectrum, but which took that form precisely because of its relational background. In other words, the more relational the partners' prior history was, the less relational-looking their subsequent deal. This conclusion seems completely counter to traditional logic, which is that the deals at the discrete end of the discrete-relational spectrum should be the "strangership" transactions. By contrast, this study found that at least some deals on the discrete end of the spectrum are at that end precisely because they are, in fact, highly relational. The study suggests that preexisting trust was sufficiently effective at lowering transaction costs of subsequent deals that parties could, essentially, afford to use a less complex, more discrete-looking contract form. From this, one could conclude that the structural form of one transaction in isolation may be an unreliable source of information about the relational nature of that exchange and, potentially, the relational expectations of the parties.

The next study representing this interesting line of research is *Interorganizational Trust, Governance Choice, and Exchange Performance*. Following the logic of the first Gulati study, the authors predicted that preexisting trust would lead parties to choose less formal transaction structures in subsequent deals, but this study added a prediction, which was that preexisting ties would have cost-lowering (i.e., performance) effects regardless of the transaction structure selected for the subsequent transaction.<sup>123</sup> The authors situated their research in the organizational substitute or complement conversation. The study, however, notes that the authors suspected that the better question in that debate was "not *whether* trust is a substitute *or* complement to formal governance, but rather *when* and *how* it may serve as both simultaneously."<sup>124</sup> In other words, the study examined whether (and if so, how) trust could serve both as a substitute for and as a complement to formal controls *simultaneously* in one exchange relationship.

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122. Kenneth G. Dau-Schmidt has noted that economists value predictive power, which requires simplicity, and sociologists value description, which requires complexity. Dau-Schmidt, *supra* note 5, at 390.

123. Ranjay Gulati & Jack A. Nickerson, *Interorganizational Trust, Governance Choice, and Exchange Performance*, 19 ORG. SCI. 688, 689 (2008) (predicting that prior ties would simultaneously have a "substitution effect" on the parties' choice of governance mode (allowing firms to shift from more to less formal/hierarchical governance modes) and a "complementary" effect on exchange performance (regardless of governance mode)). Moreover, contrary to prior similar studies, where researchers tested for either the impact of trust on either governance mode or on performance, this study considered both. *Id.* at 703.

124. *Id.* at 688 (citing scholars on each side of the substitute/complement debate). This is consistent with Catherine Mitchell, *supra* note 32.

To do that, the study investigated two different questions, each of which had usually been asked in independent research lines.<sup>125</sup> First, it investigated how past trust impacts future governance choices, and second, the authors investigated how preexisting trust deals affected the success of subsequent deals.<sup>126</sup>

The authors took their data from a comprehensive study of lead component buyers at two large U.S. automobile manufacturers.<sup>127</sup> The study tested for the variables of preexisting trust between the parties;<sup>128</sup> the parties' preferred governance mode (buy, ally, or make); the parties' assessment of the relationship's performance; and the parties' experience of conflict during the relationship.<sup>129</sup> The data showed that preexisting trust had complex effects on subsequent relationships, in some forms showing a complement effect, and in others, a substitution effect.<sup>130</sup> Interestingly, consistent with the prior study, this study concluded that the higher the level of preexisting trust, the more likely the parties were to prefer a less hierarchical governance mode (which, as noted, produces a more discrete-looking transactional form).<sup>131</sup> As to the performance impact question, the authors concluded that the preexisting trust from prior ties lowered the costs for all three governance modes whenever exchange hazards were present, which then "translate[s] directly into better exchange performance."<sup>132</sup> Overall the study found evidence of an "intricate interplay" between preexisting trust and formal governance mechanisms requiring more study.<sup>133</sup>

In sum, these particular studies challenge both the either/or structure of the substitution/complement debate and, as noted earlier, the

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125. Gulati & Nickerson, *supra* note 123, at 703.

126. *Id.* at 698 ("We focus on the effects of interorganizational trust existing prior to an exchange and examine its effects of governance choice and performance effects on current exchange.").

127. *Id.* at 693 (in 1995, they were Ford and Chrysler).

128. Using three assessments to measure the buyer's opinion of the supplier in comparison to the best alternative supplier for that commodity, including "whether the supplier has always been evenhanded in its negotiation with your company, the supplier may use opportunities that arise to profit at your expense, and you trust this supplier to treat you fairly." *Id.* at 695 tbl.1; *see also id.* at 697 (explaining various measures taken to alleviate the concern that many observable factors could correlate with preexisting interorganizational trust, like interpersonal trust).

129. Measuring the opinion of the buyer about the supplier in comparison to the best alternative supplier for that commodity, including "the supplier's frequency of significant disagreements, the ease of negotiation over sharing cost-engineering changes, and the ease of negotiation over sharing cost-material cost increases." *Id.* at 695 tbl.1.

130. *Id.* at 703-04 (noting that the results broadly supported the predictions of a substitute effect on governance choices and a complement effect on exchange performance).

131. *Id.* at 703.

132. *Id.* at 703-04. However, the authors also observed that, consistent with their prediction, "the governance-cost reduc[tion] benefits of trust are greater for buy than for ally and greater for ally than for make." *Id.* at 703.

133. *Id.* at 704.

fundamental premise of the discrete relationship, which is that discrete contracts are, in fact, discrete. Indeed, this work suggests that relational norms can have substitute and complement effects simultaneously, and also that a discrete-looking transaction may actually be a manifestation of relational ties. These insights should be incorporated into legal scholarship. To that end, the next Part suggests specific avenues for further research.

#### IV. RESEARCH IMPLICATIONS

The work highlighted in Part III demonstrates the presence and instrumental effects of relational norms in business transactions. One of the most notable aspects of this work is the simple fact that scholars have been able to economically operationalize the relational aspects of exchange.<sup>134</sup> Indeed, the reason business scholars began economically accounting for relational norms was to better account for transaction costs. Yet mainstream law and economics analysis strictly disaggregates the relational and the economic. Legal economists mostly continue to steadfastly maintain that, to have predictive power, economic models cannot account for the relational side.

One suggestion to be developed in this Part is for economically-minded law scholars to integrate the institutional perspective, which operationalizes relational contract norms, into a new empirical contract law research agenda.<sup>135</sup> This claim is developed in Section A. Then, Section B argues that the data produced by research operationalizing relational contract norms could be a source of objective evidence of relational-economic expectations, such as the threat of opportunistic behavior, within commercial subgroups.<sup>136</sup> In Section C, the Article identifies challenges to operationalizing relational contract norms, and in Section D, the Article explores further interdisciplinary possibilities.<sup>137</sup>

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134. Although Macneil, in observing the similarity in goals between transaction cost analysis and relational contract theory, pointed out multiple shortcomings in the economic approach, including a “high risk of omitting major factors.” See Macneil, *Relational Contract Theory*, *supra* note 12, at 890.

135. Indeed, a similar call was issued by Hermalin et al., *supra* note 7, when, in summary of the Contract Law chapter, the authors wrote:

In general, the economics of contract interpretation is a relatively unmined field compared to the economic analysis of contract law generally. While the general contours of legal understanding in this area are more or less consonant with the main insights of the economic theory of contract, the rapid and recent development of the economic literature has not yet been matched by a corresponding growth in legal scholarship.

Hermalin et al., *supra* note 7, at 99.

136. See, e.g., Fink et al., *supra* note 62, at 502.

137. Somewhat ironically, it seems that Macneil himself suggested similar research paths as promising directions forward, though this was in 1985. At that time, in *Relational Contract: What We Do and Do Not Know*, Macneil specifically suggested that “useful routes of future legal scholarship” included further “empirical studies like Macaulay’s . . . [which would] yield insights . . . transcending the particular area of

A. *Taking the Institutional Perspective Seriously Means Operationalizing Relational Norms*

Although institutional economics “has a long pedigree,”<sup>138</sup> one would not know it from mainstream contract law scholarship. Currently, neither institutional economics as a field nor the specific analytic tool of TCE is widely discussed in contract law literature.<sup>139</sup> That said, the newest generation of law-and-economics work—on incomplete contracting—does ask one of the same questions as institutional economics, which is how transaction costs affect contract design.<sup>140</sup> However, explicit discussion of TCE research shows up only occasionally.<sup>141</sup> When it does, the literature does not account for relational norms as a determinant of transaction costs, which are, of course, key factors in contract design.<sup>142</sup> In sum, the TCE research operationaliz-

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contracting studied,” as well as “cross-disciplinary study of existing empirical work,” which is “quite extensive in disciplines such as marketing, industrial psychology, sociology of work, and others.” Macneil, *Relational Contract*, *supra* note 35, at 510–11. Macneil thought then that that work “might yield new ways of looking at relational contract, while providing a way to test existing theories and outlooks.” *Id.* at 511. Neither suggestion seemed to be taken up at that time.

138. William K. Black, *The Imperium Strikes Back: The Need to Teach Socioeconomics to Law Students*, 41 SAN DIEGO L. REV. 231, 237–38 (2004) (recounting that the institutional perspective “was part of the classical and neoclassical models before it was ever given a name,” and that “[t]he classical theorists, Adam Smith and Hobbes, worried about institutions and recognized that a rule of law, a police power, and an effective tort and contract system were essential to a well-functioning economy”); *see also id.* at 238 (“Much of what is considered central to modern neoclassical economics is institutional economics. Coase’s theory of the firm was a seminal work in institutional economics.”).

139. There are some exceptions. One is Smith & King, *supra* note 10 (reviewing empirical studies of contracts in the legal and economic literature and arguing that organizational theories have much to contribute in future empirical study); another is Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1 (2009) (proceeding from the perspective of the New Institutional Economics to determine variables that are likely to “affect the ability [of the parties] to draft complete contracts”).

140. Richter, *supra* note 6, at 35.

141. Some exceptions include Geis, *supra* note 60; Badawi, *supra* note 139 (adapting TCE as the tool to determine variables that are likely to “affect the ability [of the parties] to draft complete contracts”); Smith & King, *supra* note 10 (noting that scholars have empirically studied contracts from the transaction cost perspective, but also from the perspectives of organization theory, resource theory, identity theory, and institutional theory); Richter, *supra* note 6; J.P. Kostritsky, “*Why Infer?*” *What the New Institutional Economics Has to Say About Law-Supplied Default Rules*, 73 TUL. L. REV. 497 (1998) (using a TCE-inspired “comparative net benefit” approach to evaluate two competing approaches to default rules: the “penalty default” approach and the “hypothetical bargain” approach); Butler & Baysinger, *supra* note 7.

142. Like institutional economics, the incomplete contracting literature is “primarily about contract design,” and so the transaction costs of real world contracting are relevant to both literatures. *See* Scott & Triantis, *supra* note 6, at 188, 190. Probably the most applicable of that literature to this project is just-emerging work recognizing the often overlooked connection between contract design and contract interpretation. Gilson et al., *supra* note 62, at 54–55 (arguing that legally sophisticated parties design contracts with interpretation issues in mind, and in doing so, often “braid both text

ing relational contract norms—specifically Macneil’s relational norms—is absent from contract law literature.

This is a loss because that research has elicited information about contractors’ expectations of relational governance and has tied those expectations to objective institutional criteria. Without that information, contract law scholarship is disempowered. Even Judge Posner seems to agree, referring to law, economics, and organizations (“LEO”) analysis<sup>143</sup> as the fourth generation of economic analysis of law scholarship.<sup>144</sup> Posner has called on the new generation of LEO scholars<sup>145</sup> to use their analytic skills to help “situat[e] law in the total system of social control, which includes custom . . . morality, reputation, and emotion.”<sup>146</sup> Situating the law in the total system of social control would inevitably mean operationalizing relational norms.

But is there room in the fourth generation of economic analysis of law for non-mathematical analysis? The question may sound apocryphal were it just coming from a non-economic analyst of law. It is not. Speaking about the crash of 2008, Judge Posner said that he now questions the fundamental premises of the formalist, mathematically-driven model of traditional economics and is reconsidering some of the virtues of older-style, more informal Keynesian analysis.<sup>147</sup> He said that the formalist, math-driven model can be out of touch with what is actually happening in the economy. Specifically, in the run-up to the crash, Posner opined that modern economists may “have lost interest in or feel for institutional detail,” and as such, lost touch with what was happening in the institution of banking.<sup>148</sup> Posner suggested that overreliance on “Chicago macroeconomic” theory kept economists from seeing how monetary policy in the early 2000s helped facilitate the crash—a blind-spot he characterized in retrospect as “pretty

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and context in their contracts,” which neither of the two dominant contract interpretation methods (formalist/textualist or incorporationist/contextualist) can adjudicate well). But while this work accounts for institutional variables, ultimately it argues for a change in contract interpretative regimes; it does not, like this Article, address the potential role of relational contracting norms in the interpretive system we have.

143. LEO means “law, economics, and organization,” which represents a different kind of law-and-economics: one which incorporates the institutional perspective. See Williamson, *Revisiting Legal Realism*, *supra* note 53.

144. Richard A. Posner, *A Review of Steven Shavell’s Foundations of Economic Analysis of Law*, 44 J. ECON. LITERATURE 406, 411 (2006). But see Williamson, *Revisiting Legal Realism*, *supra* note 53, at 385 (referring to Posner as “dismissive of organization theory”) (citing Richard A. Posner, *The New Institutional Economics Meets Law and Economics*, 149 J. INSTITUTIONAL & THEORETICAL ECON. 73 (1993)).

145. See Richter, *supra* note 6, at 35 (discussing this group of scholars and identifying their particular contributions).

146. Posner, *A Review of Steven Shavell’s Foundations of Economic Analysis of Law*, *supra* note 144, at 412.

147. John Cassidy, *Interview with Richard Posner*, NEW YORKER (Jan. 13, 2010), <http://www.newyorker.com/news-johncassidy/interview-with-richard-posner> [http://perma.cc/GQ2L-W968].

148. *Id.*



bad.”<sup>149</sup> Posner also asserted that modern economics’ tendency to be both highly mathematical and ideologically libertarian is a “dangerous combination.”<sup>150</sup> He said of the crash:

[It] called into question a whole approach to economics—[the] one that is very formal, making very austere assumptions about human rationality: people have a lot of information, a lot of foresight. They look ahead. . . . The more informal economics of Keynes has made a big comeback because people realize that even though it is kind of loose and it doesn’t cross all the “t”s and dot all the “i”s, it seems to have more of a grasp on what is going on in the economy.<sup>151</sup>

Judge Posner here seems to have invited economically-minded contract law scholars to incorporate informal, non-mathematical economic analytic methods into the next generation of research.<sup>152</sup> Incorporating non-mathematic research methods, like those of other disciplines (including sociology), would be a dramatic shift in the economic analysis of contract law research agenda.

To be sure, the basic contribution of this Article, which is that relational norms are economically operationalizable, is modest. I am not an economist, but one need not be to recognize the potential here. My contribution is to start a conversation about where to go next, and I fully concur that “the devil . . . is in the details.”<sup>153</sup> That said, at a minimum, this research suggests that there is more information, either out there already or collectible, that can inform debates of important contract law questions.

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149. *Id.*

150. *Id.*

Modern economics is, on the one hand, very mathematical, and, on the other, very skeptical about government and very credulous about the self-regulating properties of markets. That combination is dangerous. Because it means you don’t have much knowledge of institutional detail, particular practices . . . and so on. On the other hand, you have an exaggerated faith in the market.

*Id.*

151. *Id.*

152. *See id.* (finding a similarity in Keynes and Coase—not political, but methodological, observing, “they are very similar in their informality. Coase was always saying he didn’t believe in utility maximization. He didn’t believe in equilibrium. Both of them, they were not concerned with the kind of axiomatic reasoning where you start with human beings assumed to have rational calculators inside them. They are much more likely to take people as they are.”). Interestingly, David Campbell has said in reviewing Judge Posner’s most recent book explaining the stock market crash of 2008, *A Failure of Capitalism*, that it is worth reading “not [because of] anything it tells us about the crash, but what it tells us about Posner’s law and economics.” David Campbell, *The End of Posnerian Law and Economics*, 73 *MOD. L. REV.* 305, 309 (2010) (reviewing RICHARD A. POSNER, *A FAILURE OF CAPITALISM: THE CRISIS OF ‘08 AND THE DESCENT INTO DEPRESSION* (2009)).

153. Symposium, *Relational Contracting in a Digital Age*, 11 *TEX. WESLEYAN L. REV.* 675, 676 (2005) (quoting Professor Franklin G. Snyder’s introduction to panel discussion).

B. *Relational Norms Operationalized and Contract Law:  
Whither the “Immanent Law”?*

One of those debates is whether the U.C.C.’s incorporation strategy has been a mistake. In a break with the formalism of the classical common law of contract, U.C.C. Article 2 (“Article 2” or “the Code”) adopted a contextual method of contract interpretation. As to both expressed terms and gaps or silences, Article 2 directs courts to determine meaning from a transaction’s context. The term “incorporation” means to incorporate relevant norms of the parties’ commercial practices into the contract.<sup>154</sup>

Karl Llewellyn, one of the principal drafters of the U.C.C., referred to this strategy as deciding cases by their “immanent law,” meaning that the solution to any commercial problem is immanent within the commercial setting in which the problem arose.<sup>155</sup> Llewellyn believed that particular commercial settings had their own commercial rules-of-the-road, so to speak. Given that belief, the Code’s original drafters had two choices: either undertake broad-scale empirical research prior to drafting, to uncover those rules *ex ante*, or draft broad standards that would be given meaning case-by-case as the parties educated the court.<sup>156</sup> The Code drafters chose the latter strategy.

Llewellyn presumed that courts would require empirical evidence to determine what parties in particular cases meant by contextual standards studded throughout Article 2, such as commercial reasonableness, good faith, and bargain in fact.<sup>157</sup> Robert Scott wrote that “Llewellyn believed that a major purpose of the Code was to resolve disputes according to the ‘best’ commercial norms. In his view, the task of the courts was to identify and select the best commercial prototypes that were revealed in a particular commercial environment.”<sup>158</sup> However, this is not what happened. Non-specialist courts and lay jurors hear commercial cases, and according to Scott’s research, courts routinely do not require empirical evidence, but rather decide cases on the basis of some generalized, “ad-hoc Code policy.”<sup>159</sup> Maybe worse, as Timothy Muris’s research has demonstrated,

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154. See Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 193, 193 (Jody S. Kraus & Steven D. Walt eds., 2000).

155. Alexander M. Meiklejohn, *Castles in the Air: Blanket Assent and the Revision of Article 2*, 51 *WASH. & LEE L. REV.* 599, 602 (1994).

156. *Id.* (“Article 2 directs courts to discover and implement immanent solutions, deciding each case on the basis of a focused empirical inquiry. The inquiry will produce information not only about the events that led directly to the transaction in dispute, but also about any relevant aspects of the parties’ past dealings with each other and the practices of their industry.”).

157. Scott, *Is Article 2 the Best We Can Do?*, *supra* note 11, at 685 & n.26.

158. *Id.* at 685 n.26.

159. *Id.* at 686.

some courts in Code cases simply ignore subjective contextual standards like good faith.<sup>160</sup>

Multiple commentators think that incorporation was a mistake.<sup>161</sup> They believe that the drafters fundamentally erred by requiring evidence of a transaction's context without the benefit of a specialized merchant tribunal.<sup>162</sup> By eliminating the very "mechanism by which . . . local norms could be identified by courts," the Code required commercial context but not commercial expertise.<sup>163</sup> That choice has produced a rich literature arguing that the incorporation strategy of Article 2 has failed and for a return to the formalist methods of common law interpretation.<sup>164</sup>

So far, research like that in Part III has yet to be mined for data relevant to the incorporation debate. This is curious. TCE research operationalizing relational contract norms may be a reliable, objective source of evidence of immanent commercial law. For example, that work could show patterns which could help distinguish between opportunistic and non-opportunistic conduct.<sup>165</sup> Opportunism can be subtle and difficult to detect, yet whether an act is opportunistic or not is often the critical question when a contextual standard of the Code or of the parties' contract is the problem.<sup>166</sup>

An example is the Code's good faith requirement for contract modification. The good faith standard is not only contextual, but it is also subjective because it requires a court to inquire into the motives of the challenged party. In his influential article, *Opportunistic Behavior and the Law of Contracts*, Timothy Muris argued that in both common law and Article 2 cases, claims of opportunistic behavior tend to arise out of specific fact patterns in different kinds of transactions and to regularly implicate a handful of contract doctrines.<sup>167</sup> One of these doctrines is contract modification. The Code repeals the common law's preexisting duty rule requiring consideration to enforce a modification

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160. *Id.* at 541.

161. *See, e.g.*, Craswell, *supra* note 4.

162. *See, e.g.*, Gilson et al., *supra* note 62, at 52–53 (“[E]liminating the merchant jury while retaining the pervasive notion of incorporation of commercial norms was a serious drafting mistake.”).

163. *Id.* at 52 (noting that the merchant tribunal was to be “made up of a panel of experts that would find specific facts—such as whether the behavior of a contracting party was ‘commercially reasonable’ in the context of the particular dispute”).

164. *Compare* Craswell, *supra* note 4, with Jody S. Kraus & Steven D. Walt, *In Defense of the Incorporation Strategy*, in *THE JURISPRUDENTIAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 193 (Jody S. Kraus & Steven D. Walt eds., 2000).

165. In this sense the argument in this Article is entirely consistent with Timothy Muris's thesis that “certain legal principles—implicit terms of contracts—can be low-cost methods of deterring opportunistic behavior.” *See* Muris, *supra* note 71, at 522.

166. *See* Speidel, *supra* note 68, at 795 (claiming that “[m]ore particularly, the question is whether the *allegedly* opportunistic conduct is permitted or constitutes a ‘breach’ of the relational contract” (emphasis added)).

167. Muris, *supra* note 71, at 532.

and replaces it with a test of good faith.<sup>168</sup> Under the Code's permissive modification standard, if a party embedded opportunistic conduct in a request for contract modification, it would be detectable only if the court found the modification to be bad faith.

Muris argued that the Code's approach has failed to ferret out opportunistic modifications, while the common law approach has been more successful.<sup>169</sup> Muris noted that, unlike in U.C.C. section 2-209, the common law standard both puts the burden of justifying the modification on the party seeking to enforce it and requires objective evidence of circumstances that, if proven, would show whether the modification was mutually beneficial.<sup>170</sup> By contrast, courts applying section 2-209 are to inquire directly into the challenged party's subjective intentions. Perhaps because subjective evidence can be unreliable, Muris noted that courts tend to ignore section 2-209's direction to consider good faith, a standard that appears in thirty-three different Code provisions.<sup>171</sup> In sum, Muris concluded that the common law's objective inquiry into the circumstances surrounding the transaction has given the modification rule some bite, while the Code's subjective inquiry into the motives or state of mind of the party defending the modification has rendered section 2-209 relatively useless for detecting opportunism.

That said, data showing the economics of relational contract behaviors could be a source of objective evidence of opportunistic modification. Notably, in his article, Muris observed that "ultimately, determining what percentage of litigated modifications is extorted is an empirical question for which no evidence currently exists."<sup>172</sup> At that time, TCE research had not begun operationalizing relational contract norms. Who knows what it might show today? The possibilities seem endless.

Recent work on contractors' preferences of different mixes of formal and informal controls in particular transactional environments is consistent with this idea. For example, in *Braiding*, Scott and Gilson recently demonstrated that in contracts for innovation, parties often intend that informal controls (relational behaviors) should not be

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168. *See id.* at 542.

169. *Id.* at 538–39 (observing that courts have implicitly used the common law requirement that the modification be "fair and equitable in view of circumstances not anticipated by the parties when the contract was made" as a way to identify extortionate modifications from mutually beneficial ones).

170. *Id.* at 541–46 (noting that such objective evidence suggesting that the modification was mutually beneficial could include either that the party challenging the modification previously rejected a lower cost alternative, or that circumstances had changed since formation).

171. *Id.* at 552 & n.81 (observing that good faith is explicitly required in the text of thirteen Code provisions, and suggested in the comments of twenty others).

172. *Id.* at 542.

treated as enforceable by courts.<sup>173</sup> The reason is that removing the threat of enforcement in that industry at the early stages of the parties' relationship is critical to create an environment likely to take the relationship from the innovation stage to the production stage.<sup>174</sup> While not using the methods of TCE, but by more finely parsing the details about a particular contracting environment (there, the "contract for innovation"), that research generated evidence about typical parties' relational expectations in a particular commercial subgroup. That work led the authors to conclude that, in the contract for innovation setting, typical parties intend informal controls not to be enforced by courts.<sup>175</sup> One might imagine new research being similarly designed to get at a variety of different, though recurring, relational-economic expectations.

Ultimately, whether the incorporation strategy without the merchant tribunal was a mistake is outside the scope of this Article. Instead, this discussion has assumed that both the Code's incorporation strategy and broad contextual standards like good faith are here to stay.<sup>176</sup> This Section has claimed that there are specific recurring issues in commercial litigation, such as the possibility of opportunistic contract modification, which could be informed by economically operationalizing relational contract norms. The next Section will consider challenges of applying academic research as evidence in the commercial litigation context.

### C. *Challenges and Possibilities*

Mining social science research for patterns of the economic impact of relational expectations certainly presents challenges. The research in *Braiding* was undertaken to show how in a particular industry, typical parties have certain expectations. The same will not always be true in the litigation context. Specifically, if parties expect to draw upon existing research as a source of evidence in a particular case, the proponent would need to meet multiple evidentiary hurdles, including questions about the data source of each study (primary or secondary) and about the generalizability of any single study's results. In any particular research model, the particular variables selected can be idiosyncratic to that particular setting, so that findings may not be generalizable across different settings. Specifically, as George Geis

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173. Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1386 (2010) ("Courts, lacking guidance in enforcing braided contractual strategies, can be tempted to impose too much formal enforcement, and thus to undermine unwittingly the complementary interaction between formal and informal enforcement.").

174. *Id.* at 1399–1400 (arguing that, in this context, the threat of legal sanctions can degrade a relationship when that threat "makes the parties' actions and performance less observable").

175. *Id.* at 1446.

176. U.C.C. § 2-202.

has noted, idiosyncratic variables include both structural forms of inter-firm transactions and contracting hazards.<sup>177</sup> In the context envisioned here, analysts would have to add an additional variable to that list, relational contracting norms, including prior relational ties. The work seems more readily promising as a source of data from which academics could observe trends—either in contract design, as with *Braiding*, or in recurrent opportunistic conduct, as suggested by *Opportunistic Behavior*.

Cost is another concern. Empirical research is expensive to undertake if it does not already exist.<sup>178</sup> Purely academic research is one thing, but could new research be developed by an academic engaged as an expert, or as a court-appointed master, in a particular case? Who would pay—the proponent of the evidence, the litigants together, or the court? What if the challenged practice is new and so not yet reflected in any existing data? What about the expertise required to collect new data? In short, there are many similar practical issues.<sup>179</sup>

The flip side is that a study can be designed to investigate a specific recurrent problem in commercial law. This happens all the time with empirical research. Yet the sheer vastness of the amount of information that could be collected is overwhelming. However, it seems to be what Llewellyn envisioned for commercial litigation,<sup>180</sup> and it is being done little by little in the contract design context. While it has been assumed that obtaining reliable, objective specialized data is not possible,<sup>181</sup> this assumption could shift if it turns out, by adding the institutional perspective and operationalizing relational norms, that immanent commercial norms are more reliably and objectively provable than we previously thought. And while some have called for an overhaul of Article 2 to reverse the incorporation strategy or for a panoply of other reforms, any radical change soon seems unrealistic. Therefore, until legal scholars begin to either mine this data or generate our own, we will continue to make arguments about contractors' economic expectations of relational behaviors and about the eco-

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177. Geis, *supra* note 60, at 246–50 (noting difficulties with this sort of empirical research, and cautioning that “it is difficult to draw grand conclusions from a high level survey of this varied terrain”).

178. *See id.*

179. *See, e.g.,* Scott & Triantis, *supra* note 6, at 195–200 (discussing the challenges that the existence of the civil adversarial system—both evidentiary and procedural variables—produce for the economic analysis of incomplete contracting). For a thoughtful take on the tension between generalized expert evidence offered to help courts make particularized calls in individual cases, see David L. Faigman et al., *Group to Individual (G2i) Inference in Scientific Expert Testimony*, 81 U. CHI. L. REV. 417 (2014).

180. *See* Scott, *Is Article 2 the Best We Can Do?*, *supra* note 11, at 685 & n.26, 688.

181. Robert E. Scott, *The Uniformity Norm in Commercial Law: A Comparative Analysis of Common Law and Code Methodologies*, in *THE JURISDICTIONAL FOUNDATIONS OF CORPORATE AND COMMERCIAL LAW* 149, 175 (Jody S. Kraus & Steven D. Walt eds., 2007).

conomic relevance of context based largely on theory and conjecture, not data.

#### D. *Beyond Efficiency*

As described above, TCE assumes the normative goal of efficiency, yet behavioralists and other economists are exploring the possibility that economic exchange could be motivated in part by other values. This work comes at a time when general enthusiasm for “economic imperialism” is waning—today, even economists may legitimately question the normative exclusivity of wealth-maximizing assumptions.<sup>182</sup> Importantly, the imperialism criticism does not mean that the wealth-maximizing assumption has no value, but instead that it cannot explain everything.<sup>183</sup> As David Campbell has observed, even Ian Macneil was “perfectly happy to acknowledge that maximizing assumptions have enormous value in technical analysis.”<sup>184</sup> Non-maximizing assumptions might have real value in the analysis of relational norms, whether that analysis is technical and mathematical or more informal and unmathematical.<sup>185</sup>

Economists from strategic management to behavioral economics have begun this work on the technical side, using economic modeling in both conceptual and experimental research.<sup>186</sup> Through such work, these scholars have observed that, although complicated, economists can usefully study values other than wealth maximization.<sup>187</sup> Over

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182. For the genesis of the phrase “economic imperialism,” see Black, *supra* note 138, at 232 (“George Stigler’s memoir referred to economics as the ‘Imperial Science’ because economists had colonized so many of the social sciences. . . Stigler wrote at a time that the Imperium was in its ascendancy. Now, it is in crisis . . . . Recent Nobel Prizes in economics have gone to behavioral and institutional economists. . . . Unfortunately, most law and economics texts were written, and many law and economics scholars were educated, at a time when the Imperial Science was conquering the world and continue to teach propositions that have been falsified—sometimes decades ago.” (footnotes omitted)).

183. See, e.g., *id.* (distinguishing “socioeconomics” from the “imperial science” of economics, and arguing in favor of teaching the former).

184. Campbell, *The Incompleteness of Our Understanding of the Law and Economics of Relational Contract*, *supra* note 58, at 677.

185. Cassidy, *supra* note 147 (quoting Posner as remarking that Frank Knight and Ronald Coase, though not sharing political commitments, did share the lack of a taste for formal, mathematical economic methodologies).

186. See, e.g., Steven C. Hackett, *Is Relational Exchange Possible in the Absence of Reputations and Repeated Contact?*, 10 J. LAW ECON. & ORG. 360 (1994) (in experimental study, finding that even when strategic conditions thought necessary to support relational exchange—repeat play and reputation concerns—were removed, players still respected the proportionality principles which were previously thought to be solely the result of strategic, and not intrinsic, fairness values).

187. It seems that one key to those scholars’ success has been to extend, but not to replace, the rational action model by relaxing some of its less realistic assumptions about human behavior. See, e.g., Matthew Rabin, *An Approach to Incorporating Psychology into Economics*, 103 AM. ECON. REV. 617 (2013) (arguing generally that psychological realism can improve our understanding of economic phenomena if operationalized properly, as “when done with the mathematical and statistical rigor

time, perhaps their work will make it easier to release the wealth-maximization assumption from its imperialist lock. Or, maybe we only need to spread Judge Posner's word—Ronald Coase “didn't believe in utility maximization.”<sup>188</sup>

Relatedly, and finally, scholars in multiple fields have begun to reconceptualize self-interest.<sup>189</sup> Operationalizing relational norms is surely relevant to that project. To this end, one place to start is with recent work by historians and economists alike who assert that, contrary to popular conceptions, Adam Smith assumed that the invisible hand would only work if set within a social and moral framework that constrained its abuses.<sup>190</sup> Indeed, even a modern father of general equilibrium theory, Kenneth Arrow, emphasized the need to learn more about the interaction of the market and its social fabric: “My own position tends very much to emphasize certain social and structural factors in the workings of any economic system. In many ways, the prevailing neoclassical ‘paradigm’ . . . is deficient because it ignores the social-structural basis.”<sup>191</sup> A reconceptualized notion of self-interest—one that accepts the dualism of the human economic actor, and thus expands the standard assumption of what it means to maximize utility or to interpret revealed preferences—could go a long way in bridging the economic and social analyses of contract.

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required by mainstream economic questions and methods”); Matthew Rabin, *Incorporating Limited Rationality into Economics*, 51 J. ECON. LITERATURE 528 (2013) (expressing support for modeling bounded rationality within the traditional, neoclassical framework, both because doing so properly adjusts the utility model to include preferences other than wealth maximization, but at the same time, consistent with rationality, because optimization models can help reveal limits to rationality). For a similar observation in contract law, see Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1672 (2003) (concluding that “the experimental evidence strongly suggests that the effect of reciprocal fairness, an effect that thus far has been neglected in contract theory, is an important element in optimal contract design”).

188. Cassidy, *supra* note 147.

189. This project is already underway in some disciplines, including behavioral economics. From the relational contract theory perspective, this work is being done by David Campbell. See, e.g., Campbell, *The End of Posnerian Law and Economics*, *supra* note 152, at 326–27. It will also be the subject of a forthcoming companion paper to this one.

190. E.g., PATRICIA H. WERTHANE, ADAM SMITH AND HIS LEGACY FOR MODERN CAPITALISM (1991) (historic account); Black, *supra* note 138, at 237 (economic account from a law professor's perspective) (“The classical theorists, Adam Smith and Hobbes, worried about institutions and recognized that a rule of law, a police power, and an effective tort and contract system were essential to a well-functioning economy. They recognized that the unseen hand needed a backbone to function, and that a legal system, police, and courts were all essential institutions to effective markets.” (footnote omitted)).

191. Campbell, *The Incompleteness of Our Understanding of the Law and Economics of Relational Contract*, *supra* note 58, at 677 (quoting Kenneth J. Arrow, *Economic Development: The Present State of the Art*, reprinted in 6 COLLECTED PAPERS OF KENNETH J. ARROW 183 (1985)).



## V. CONCLUSION

Mainstream contract law scholarship has thus far failed to take the relational contract theory critique of contract law seriously.<sup>192</sup> By contrast, the conceptual and empirical research canvassed here suggests that the relationalist designation has significant meaning to contractors and relationally-minded economists. This Article suggests that we begin to economically operationalize the social and relational aspects of exchange. Existing business research, together with new empirical legal research combining relational context with institutional economic or organizational analysis, might well lead us toward an understanding of the economics of contractors' relational expectations. That understanding, over time, may help courts better isolate opportunistic conduct, help business people secure more predictable results from litigation, and better synchronize contract law with commercial practices. It may, over time, help us better understand what it means to contract.

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192. Cf. Richard Craswell, *The Relational Move: Some Questions From Law and Economics*, 3 S. CAL. INTERDISC. L.J. 91, 96 (1993) ("Debates about the accuracy of economists' predictions would be relevant if relational theorists were claiming to offer superior predictions regarding the same commercial behavior. It seems to me, however, that relational theorists are interested in predicting *different* behavior than economists are.").