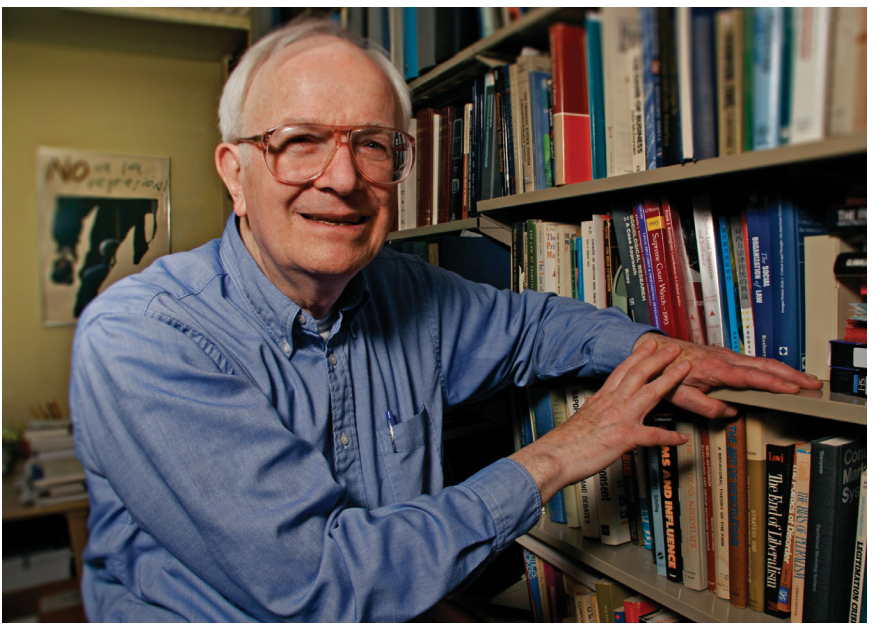
REVISITING THE CONTRACTS SCHOLARSHIP OF STEWART MACAULAY

This book contains the papers prepared for a conference held at the Wisconsin Law School in 2011 to honour the work of Stewart Macaulay, one of the most famous contracts scholars of his generation. Macaulay has been writing about contracts and contract law for over 50 years; the 1960s were particularly productive years for him, when he introduced many novel ideas into the scholarly world. Macaulay's foundational work for what is now called relational contract theory was published during this period. Macaulay is also known for his use of empirical research and interdisciplinary theories to illuminate our knowledge of contracting practices.

The papers in this volume reflect, in diverse ways, on the subsequent influence and the contemporary relevance of Macaulay's work. All the contributors are important contracts scholars in their own right: David Campbell and John Wightman from the UK, Brian Bix, Jay Feinman, Robert Gordon, Claire Hill, Charles Knapp, Ethan Leib, Deborah Post, Edward Rubin, Carol Sanger, Robert Scott, Gordon Smith, Josh Whitford (with Li-Wen Lin) and William Woodward from the USA. The volume also reproduces Macaulay's most cited paper, 'Non-Contractual Relations in Business', and excerpts from two other important papers of his, 'Private Legislation and the Duty to Read – Business Run by IBM Machine, the Law of Contracts and Credit Cards', and 'The Real and The Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules'.

International Studies in the Theory of Private Law: Volume 10



Stewart Macaulay in his office at Wisconsin Law School

Revisiting the Contracts Scholarship of Stewart Macaulay

On the Empirical and the Lyrical

Edited by
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and
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International Studies in the Theory of Private Law

This series of books edited by a distinguished international team of legal scholars aims to investigate the normative and theoretical foundations of the law governing relations between citizens. The context for such investigations of private law systems is set by important modern tendencies in systems of governance. The advent of the regulatory state marks the withdrawal of the state from direct control and management of social and economic activity, and the adoption instead of procedural regulation and co-regulatory strategies that promote the use of private law techniques of ordering and self-regulation in social and economic interactions between citizens. The tendency known as globalisation and the corresponding increases in cross-border trade produce the responses of transnational regulation of commerce and private governance regimes, and these new systems of governance challenge the hegemony of traditional national private law systems. Furthermore, these tendencies towards transnational governance regimes compel an interaction between different national legal traditions, with their differences in culture and philosophy as well as their differences based upon variations in market systems, which provokes questions not only about competing policy frameworks but also about the nature and adequacy of different kinds of legal reasoning.

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Preface

Overview

Stewart Macaulay began his extremely productive academic career at the Wisconsin Law School in 1957. He was assigned to teach Contracts as his first course. The pre-eminent scholar at the Law School at that time was Professor Willard Hurst, a man who had pioneered interdisciplinary scholarship in law schools. Hurst was renowned for how generous he was in giving time and assistance to his younger colleagues.[1] Not long before, Macaulay had begun a very successful marriage and intellectual collaboration with Jacqueline Ramsey.[2] Jacqueline's father, John R (Jack) Ramsey, had been general manager of SC Johnson & Sons, a worldwide manufacturing company with headquarters in Racine, Wisconsin. Conversations with his father-in-law led Macaulay to conduct an extensive empirical study of business practices and then write the paper that became his most famous article, 'Non-Contractual Relations in Business – A Preliminary Study'.[3] Hurst was very interested in this paper and connected Macaulay to some prominent sociologists of the day, leading to its publication in the *American Sociological Review*.[4] Hurst thus helped to launch Macaulay in a direction that has resulted in his recognition as a leading scholar in both contracts and the interdisciplinary study of law.

Throughout the 1960s, both before and after the publication of this most famous paper, Macaulay published other articles that, though not as well known, nonetheless broke new paths in contracts scholarship and have

[1] S Macaulay, 'In Memoriam: Willard's Law School?', (1997) 1997 *Wisconsin Law Review* 1163, 1170 (describing the ways in which Hurst was an 'ideal mentor').

[2] Macaulay credits his late wife with making his career possible, not the least because until her death she edited all his publications: 'A Jackie edit was thorough and challenging. She had to understand every sentence and see why it was where it was in the manuscript.' S Macaulay, 'Crime and Custom in Business Society', (1995) 22 *Journal of Law and Society* 248–58.

[3] In addition to Jack Ramsey's influence on 'Non-Contractual Relations in Business', his correspondence with Frank Lloyd Wright concerning the Johnson building in Racine inspired a later article. S Macaulay, 'Organic Transactions: Contract, Frank Lloyd Wright and the Johnson Building,' (1996) 1996 *Wisconsin Law Review* 75, fn a (noting that Jacqueline Macaulay found her father's correspondence with Frank Lloyd Wright).

[4] For fuller accounts of the circumstances surrounding the preparation and publication of Macaulay's most famous article, see Macaulay, 'In Memoriam' (n 1) 1170; Macaulay, 'Crime and Custom' (n 2) 248–58. The article has been included in an anthology of the 20 most important works of American legal thought. D Kennedy and W Fisher, *The Canon of American Legal Thought* (Princeton, Princeton University Press, 2006) 445–59.

proved highly influential. Macaulay became, along with his good friend, Ian Macneil, one of the two legal theorists to participate in the founding of what has become known as relational contract theory. Sparked by Macaulay's formal retirement (though he continues to teach and write), the Wisconsin Law School decided to host a conference revisiting his early scholarship and reflecting on its impact on subsequent contracts scholarship. Sixteen well-known contracts scholars from the UK and the USA were invited to present papers and all responded affirmatively. The conference was held in Madison on 21–22 October 2011. Fifteen of the papers were later revised and are included in this volume.

This volume begins with a reproduction of Macaulay's most famous article. It also provides excerpts from another article from the 1960s, 'Private Legislation and the Duty To Read – Business Run by IBM Machine, the Law of Contracts and Credit Cards',[5] and from a more contemporary Macaulay article that is much commented upon, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules'.[6] Preceding these excerpts there is a bibliography of all of Macaulay's major publications.

We have divided the 15 conference papers into four sections, as shown in the Table of Contents. Such categorisations are inevitably oversimplifications, and perhaps even misleading. There are cross-currents in many of the papers that could have led to placement in a different section. What is common to all the papers is that they refer to one or more of Macaulay's early contracts articles, reflecting on their influence on subsequent scholarship by others and their relevance to current developments.

In the first section there are four papers that discuss the relationship of Macaulay's work to contract and legal theory. Robert W Gordon, in 'Is the World of Contracting Relations One of Spontaneous Order or Pervasive State Action? Stewart Macaulay Scrambles the Public–Private Distinction', describes how Macaulay's work makes it difficult to maintain that there is a strong public/private dichotomy, despite the importance of that distinction to so many of the most influential works on contract theory. Edward Rubin, in 'Empiricism's Crucial Question and the Transformation of the Legal System', relates Macaulay's commitment to empirical studies to theories about how equilibriums in social and legal theory and practice get dislodged and readjusted. Rubin draws on the important work of Niklas Luhman and Gunther Teubner. Robert Scott, in 'The Promise and the Peril of Relational Contract Theory', identifies two schools of thought in American relational contract theory – one identified with the law and economics tradition and the other with the law and society tradition. Scott

[5] S Macaulay, 'Private Legislation and the Duty To Read – Business Run by IBM Machine, the Law of Contracts and Credit Cards' (1966) 19 *Vanderbilt Law Review* 1051.

[6] S Macaulay, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66 *Modern Law Review* 44.

calls for the two schools to respect each other's traditions and to draw together, in order not to become overwhelmed by contract theorists who pay no attention to empirical studies on contracting behaviour. Jay Feinman, in 'Ambition and Humility in Contract Law', explores the rich theoretical organisation of contract and legal system policies developed in Macaulay's early article, 'Private Legislation and the Duty to Read'.[7] Feinman concludes that Macaulay's theoretical construct continues to be powerful both as description and as a tool for critical evaluation of contract law in action.

The second section also contains four papers, all dealing in various ways with contractual practices between businesses. David Campbell, in 'What Do We Mean By the Non-Use of Contract?', defends the relevance of legal rules to contracts between businesses, but argues that our traditional legal theory – classical contract law – needs to be discarded, in favour of a theory that understands that co-operation, not adversarialness, is the core principle reflected in both contractual behaviour and, as properly understood, contract law. Li-Wen Lin and Josh Whitford, in 'Conflict and Collaboration in Business Organisation: A Preliminary Study', present empirical findings in their quantitative study of the dynamics between co-operation and conflict in inter-organisational networks; they argue that not only dyads but also triads of allied businesses need to be examined to understand these dynamics. Their paper also traces how Macaulay's 'Non-Contractual Relations in Business – A Preliminary Study' anticipated and influenced many of the themes in contemporary economic sociology. Claire A Hill, in 'What Mistakes Do Lawyers Make in Complex Business Contracts, And What Can and Should be Done About Them?', offers a typology of mistakes lawyers make in written contracts created in complex business deals and speculates why these mistakes persist. Because of the limited (though not negligible) impact of the content of written contracts on how businesspeople behave in contract performance, she concludes that the mistakes do little harm and perhaps even some good. Brian Bix, in 'The Role of Contract: Stewart Macaulay's Lessons from Practice', emphasises Macaulay's critique of formalism in both legal education and scholarship, as well as Macaulay's teaching that the true subject of contract law is the actual practices and promises of business people and other parties engaged in transactions.

Our third section contains papers concerning contractual relations where at least one party is an individual, acting in a consumer or other non-business capacity. Ethan Leib, in 'What is the Relational Theory of Consumer Form Contract?', argues that the doctrine of 'reasonable expectations' offers the best judicial tool for policing consumer deals and that

[7] Macaulay, 'Private Legislation' (n 5).

the key question is what counts as a reasonable expectation, a question that he believes should be empirically evaluated. Carol Sanger, in 'Acquiring Children Contractually: Relational Contracts at Work at Home', addresses use of contracts to provide for post-adoption visitation rights. She draws upon the relational approach to contracts generally and also on an article published by Jacqueline and Stewart Macaulay in 1978, 'Adoption for Black Children: A Case Study of Expert Discretion'.[8] Charles Knapp, in 'Is There a "Duty to Read"?', examines recent case law concerning this sometimes asserted duty and develops a suggested judicial methodology for deciding whether to hold parties to a signed writing. He argues that reading should not be conceived of as a duty and that assent in these circumstances should be no more than a rebuttable presumption.

The final section contains four papers using relational contract theory to critique various contract doctrines. William J Woodward Jr, in 'Restitution Without Context: An Examination of the Losing Contract Problem in the *Restatement (Third) of Restitution*', builds upon Macaulay's 1959 article, 'Restitution in Context'.[9] Woodward examines the Restatement's complex compromise approach to the losing contract problem, which is to use the 'contract rate' to set recovery, and questions both its normative premises and predicted effects. John Wightman, in 'Contract in a Pre-Realist world: Professor Macaulay, Lord Hoffmann and the Rise of Context in the English Law of Contract', explores a number of opinions by Lord Hoffmann in English House of Lords (now the Supreme Court) decisions, and argues that these decisions have allowed prevailing business practices, of the type effectively studied and exposed by Macaulay, to influence the application of historic doctrines of neoclassical contract law, particularly with respect to the availability of consequential damages. Deborah Post, in 'The Deregulatory Effects of Seventh Circuit Jurisprudence', critiques several contract law opinions by Judges Richard Posner and Frank Easterbrook of the Seventh Circuit Court of Appeals (in the USA), arguing that they fail to use Macaulay's commitment to understanding what is actually happening in a transaction to help reach a result that is fair and just. Gordon Smith, in 'Doctrines of Last Resort', offers a view about why such contract law doctrines as good faith, fiduciary duty and unjust enrichment play an important role in controlling opportunistic party behaviour. Such behaviour is mostly deterred by informal social sanctions, as Macaulay has observed, but in Smith's view these 'doctrines of last resort' play an important supportive role precisely when informal sanctions prove inadequate.

[8] J Macaulay and S Macaulay, 'Adoption for Black Children: A Case Study of Expert Discretion' in R Simon (ed), *Research in Law and Sociology: An Annual Compilation of Research* (Greenwich, JAI Press, 1978) 265–318.

[9] S Macaulay, 'Restitution in Context' (1959) 107 *University of Pennsylvania Law Review* 1133.

MACAULAY'S TEACHING MATERIALS

No accounting of Stewart Macaulay's impact on the world of the academic study of contract law and behaviour would be complete without some discussion of the contracts teaching materials that bear his (and our) names.[10] Since no paper describes these materials, we provide a brief account here. These materials express a distinct point of view, closely associated with Macaulay's early contracts scholarship. They use the term 'Law in Action' to describe their perspective, which emphasises how legal doctrine influences or fails to influence the behaviour of contracting parties (and others). The materials include several in-depth contextual discussions of contractual interactions, why litigation occurred, and how the litigation affected the relationship.[11] They stress that law is not free and that the haves often come out ahead. The approach is challenging for both teachers and students, a point acknowledged in an introductory chapter:

> One major theme of the course is that things are not as they seem. But debunking can be upsetting. It can lead to a resigned cynicism that undercuts any effort toward bettering the world. It is true that naïve idealism may seriously mislead those whose goal is to effect change . . . We think good lawyers are skeptical idealists, aware of how the system works but unwilling to retreat into an easy cynicism.[12]

These materials have their origin in Macaulay's early teaching career. When Macaulay began teaching at Wisconsin in 1957 and was assigned Contracts as a class, he adopted a casebook co-authored by Malcolm Sharp, one of his mentors as a Bigelow Fellow at the University of Chicago Law School.[13] That casebook emphasised competing themes of autonomy and a minimal state as opposed to regulation as a way of achieving social justice. Macaulay immediately began to supplement the casebook with materials emphasising the law in action. Later his long-time colleagues and casebook co-editors, Whitford and Kidwell, joined the Wisconsin law faculty, and both used and contributed to the growing set of supplementary materials. When the other great relational contract legal theorist of the era, Ian Macneil, produced his first casebook in 1971, Macaulay and his Wisconsin contracts colleagues adopted it.[14] It was not many years

[10] S Macaulay and others (eds), *Contracts: Law in Action*, 3rd edn (New Providence, LexisNexis, 2010).

[11] The materials were significantly influenced by Richard Danzig's important book, *The Capability Problem in Contract Law*, first published in 1978 (Mineola, Foundation Press) and intended as a supplement to a traditional Contracts casebook. Macaulay and his colleagues contributed importantly to Danzig's initial book.

[12] Macaulay and others, *Contracts: Law in Action* (n 10) 26–27.

[13] F Kessler and M Sharp, *Contracts: Cases and Materials* (New York, Prentice-Hall, 1953).

[14] I Macneil, *Cases and Materials on Contracts: Exchange Transactions and Relationships* (Mineola, Foundation Press, 1971). The Wisconsin contracts teachers actually used a pre-publication draft of these materials and offered feedback to Macneil before publication.

later, however, when a Wisconsin supplement to the Macneil casebook began growing. Within the decade the supplement had become so voluminous that the Wisconsin contracts group abandoned the Macneil casebook and began teaching from their own materials that were produced annually by the very efficient 'Copy Shop' at the Wisconsin Law School. For the next decade and more the materials received annual revisions, contributed to by all of Macaulay's colleagues at Wisconsin who were teaching Contracts. The materials were finally stabilised and published, initially in 1993.[15] For the current third edition, published in 2010, Jean Braucher of the University of Arizona College of Law joined the group of editors.[16] The casebook is now adopted in approximately 15 law schools.

DEBTS OF GRATITUDE

Our greatest debt of gratitude goes to the authors of the papers that make up this volume. We also are indebted to many other academics who served as discussants at the conference or who attended and participated in the debate.[17] The conference itself was hosted by the Wisconsin Law School, through the auspices of its Institute for Legal Studies.[18] We are grateful for institutional support provided by the Institute and the Law School. We are especially indebted to the Institute's Associate Director, Pamela Hollenhorst. Her skill and experience in running conferences are extraordinary. Without Pam's able efforts and wise guidance, the conference would never have happened.

This book would not have come to fruition without the able assistance of Natalie Hoeper, JD, 2012, University of Wisconsin Law School. Natalie served both as a copyeditor and as overall administrative assistant in the task of converting conference papers into book chapters. Natalie's dedication to her job, her promptness in completing her tasks, and her knowledge of the Hart Style manual are all of the highest order. Natalie also helped out with the conference. We have every confidence that Natalie is headed to a highly successful legal career.

[15] The first edition was initially published, in 1993, by the Institute for Legal Studies at Wisconsin Law School. This edition was commercially published in 1995 by Michie Company. Marc Galanter joined Macaulay, Kidwell and Whitford as a co-editor of the first edition.

[16] The Michie Company was acquired by LexisNexis, the publisher of the second and third editions. The second edition appeared in 2003.

[17] The website for the conference is: www.law.wisc.edu/ils/2011contractsconf/homepage.html. The following persons served as discussants for the panels held at the conference: Professors Lisa Alexander (Wisconsin), Jean Braucher (Arizona), Alan Hyde (Rutgers-Newark), Jonathan Lipson (Wisconsin), Keith Rowley (Nevada-Las Vegas), Daniel Schwarcz (Minnesota), William Whitford (Wisconsin) and Jason Yackee (Wisconsin).

[18] The conference was funded by the Contracts Enrichment Fund at Wisconsin Law School. This Fund receives the royalties from contracts casebook described above.

John Kidwell, one of our co-editors, passed away in February 2012. Before his untimely death, John fully participated in the planning for the conference, and he performed the substantive edits on some of the chapters in this volume. We miss John more than we can describe, and we are deeply indebted to him for all his contributions over many years to the Wisconsin contracts team. We know that Stewart shares these sentiments.

Jean Braucher
William Whitford
May, 2012

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Non-Contractual Relations in Business: A Preliminary Study[*]

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Preliminary findings indicate that businessmen often fail to plan exchange relationships completely, and seldom use legal sanctions to adjust these relationships or to settle disputes. Planning and legal sanctions are often unnecessary and may have undesirable consequences. Transactions are planned and legal sanctions are used when the gains are thought to outweigh the costs. The power to decide whether the gains from using contract outweigh the costs will be held by individuals having different occupational roles. The occupational role influences the decision that is made.

WHAT GOOD IS contract law? who uses it? when and how? Complete answers would require an investigation of almost every type of transaction between individuals and oganizations. In this report, research has been confined to exchanges between businesses, and primarily to manufacturers.[1] Furthermore, this report will be limited to a presentation of the findings concerning when contract is and is not used and to a tentative explanation of these findings.[2]

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[1] The reasons for this limitation are that (a) these transactions are important from an economic standpoint, (b) they are frequently said in theoretical discussions to represent a high degree of rational planning, and (c) manufacturing personnel are sufficiently public-relations-minded to cooperate with a law professor who wants to ask a seemingly endless number of questions. Future research will deal with the building construction industry and other areas.

[2] For the present purposes, the what-difference-does-it-make issue is important primarily as it makes a case for an empirical study by a law teacher of the use and nonuse of contract by businessmen. First, law teachers have a professional concern with what the law ought to be. This involves evaluation of the consequences of the existing situation and of the possible alternatives. Thus, it is most relevant to examine business practices concerning contract if one is

This research is only the first phase in a scientific study.[3] The primary research technique involved interviewing 68 businessmen and lawyers representing 43 companies and six law firms. The interviews ranged from a 30-minute brush-off where not all questions could be asked of a busy and uninterested sales manager to a six-hour discussion with the general counsel of a large corporation. Detailed notes of the interviews were taken and a complete report of each interview was dictated, usually no later than the evening after the interview. All but two of the companies had plants in Wisconsin; 17 were manufacturers of machinery but none made such items as food products, scientific instruments, textiles or petroleum products. Thus the likelihood of error because of sampling bias may be considerable.[4] However, to a great extent, existing knowledge has been inadequate to permit more rigorous procedures – as yet one cannot formulate many precise questions to be asked a systematically selected sample of "right people." Much time has been spent fishing for relevant questions or answers, or both.

Reciprocity, exchange or contract has long been of interest to sociologists, economists and lawyers. Yet each discipline has an incomplete view of this kind of conduct. This study represents the effort of a law teacher to draw on sociological ideas and empirical investigation. It stresses, among other things, the functions and dysfunctions of using contract to solve exchange problems and the influence of occupational roles on how one assesses whether the benefits of using contract outweigh the costs.

To discuss when contract is and is not used, the term "contract" must be specified. This term will be used here to refer to devices for conducting exchanges. Contract is not treated as synonymous with an exchange itself,

interested in what commercial law ought to be. Second, law teachers are supposed to teach law students something relevant to becoming lawyers. These business practices are facts that are relevant to the skills which law students will need when, as lawyers, they are called upon to create exchange relationships and to solve problems arising out of these relationships.

[3] The following things have been done. The literature in law, business, economics, psychology, and sociology has been surveyed. The formal systems related to exchange transactions have been examined. Standard form contracts and the standard terms and conditions that are found on such business documents as catalogues, quotation forms, purchase orders, and acknowledgment-of-order forms from 850 firms that are based in or do business in Wisconsin have been collected. The citations of all reported court cases during a period of 15 years involving the largest 500 manufacturing corporations in the United States have been obtained and are being analyzed to determine why the use of contract legal sanctions was thought necessary and whether or not any patterns of "problem situations" can be delineated. In addition, the informal systems related to exchange transactions have been examined. Letters of inquiry concerning practices in certain situations have been answered by approximately 125 businessmen. Interviews, as described in the text, have been conducted. Moreover, six of my students have interviewed 21 other businessmen, bankers and lawyers. Their findings are consistent with those reported in the text.

[4] However, the cases have not been selected because they *did* use contract. There is as much interest in, and effort to obtain, cases of nonuse as of use of contract. Thus, one variety of bias has been minimized.

which may or may not be characterized as contractual. Nor is contract used to refer to a writing recording an agreement. Contract, as I use the term here, involves two distinct elements: (a) Rational planning of the transaction with careful provision for as many future contingencies as can be foreseen, and (b) the existence or use of actual or potential legal sanctions to induce performance of the exchange or to compensate for nonperformance.

These devices for conducting exchanges may be used or may exist in greater or lesser degree, so that transactions can be described relatively as involving a more contractual or a less contractual manner (a) of creating an exchange relationship or (b) of solving problems arising during the course of such a relationship. For example, General Motors might agree to buy all of the Buick Division's requirements of aluminum for ten years from Reynolds Aluminum. Here the two large corporations probably would plan their relationship carefully. The plan probably would include a complex pricing formula designed to meet market fluctuations, an agreement on what would happen if either party suffered a strike or a fire, a definition of Reynolds' responsibility for quality control and for losses caused by defective quality, and many other provisions. As the term contract is used here, this is a more contractual method of creating an exchange relationship than is a home-owner's casual agreement with a real estate broker giving the broker the exclusive right to sell the owner's house which fails to include provisions for the consequences of many easily foreseeable (and perhaps even highly probable) contingencies. In both instances, legally enforceable contracts may or may not have been created, but it must be recognized that the existence of a legal sanction has no necessary relationship to the degree of rational planning by the parties, beyond certain minimal legal requirements of certainty of obligation. General Motors and Reynolds might never sue or even refer to the written record of their agreement to answer questions which come up during their ten-year relationship, while the real estate broker might sue, or at least threaten to sue, the owner of the house. The broker's method of *dispute settlement* then would be more contractual than that of General Motors and Reynolds, thus reversing the relationship that existed in regard to the "contractualness" of the creation of the exchange relationships.

TENTATIVE FINDINGS

It is difficult to generalize about the use and nonuse of contract by manufacturing industry. However, a number of observations can be made with reasonable accuracy at this time. The use and nonuse of contract in creating exchange relations and in dispute settling will be taken up in turn.

The creation of exchange relationships. In creating exchange relationships, businessmen may plan to a greater or lesser degree in relation to several types of issues. Before reporting the findings as to practices in creating such relationships, it is necessary to describe what one can plan about in a bargain and the degrees of planning which are possible.

People negotiating a contract can make plans concerning several types of issues: (1) They can plan what each is to do or refrain from doing; e.g., S might agree to deliver ten 1963 Studebaker four-door sedan automobiles to B on a certain date in exchange for a specified amount of money. (2) They can plan what effect certain contingencies are to have on their duties; e.g., what is to happen to S and B's obligations if S cannot deliver the cars because of a strike at the Studebaker factory? (3) They can plan what is to happen if either of them fails to perform; e.g., what is to happen if S delivers nine of the cars two weeks late? (4) They can plan their agreement so that it is a legally enforceable contract – that is, so that a legal sanction would be available to provide compensation for injury suffered by B as a result of S's failure to deliver the cars on time.

As to each of these issues, there may be a different degree of planning by the parties. (1) They may carefully and explicitly plan; e.g., S may agree to deliver ten 1963 Studebaker four-door sedans which have six cylinder engines, automatic transmissions and other specified items of optional equipment and which will perform to a specified standard for a certain time. (2) They may have a mutual but tacit understanding about an issue; e.g., although the subject was never mentioned in their negotiations, both S and B may assume that B may cancel his order for the cars before they are delivered if B's taxi-cab business is so curtailed that B can no longer use ten additional cabs. (3) They may have two inconsistent unexpressed assumptions about an issue; e.g., S may assume that if any of the cabs fails to perform to the specified standard for a certain time, all S must do is repair or replace it. B may assume S must also compensate B for the profits B would have made if the cab had been in operation. (4) They may never have thought of the issue; e.g., neither S nor B planned their agreement so that it would be a legally enforceable contract. Of course, the first and fourth degrees of planning listed are the extreme cases and the second and third are intermediate points. Clearly other intermediate points are possible; e.g., S and B neglect to specify whether the cabs should have automatic or conventional transmissions. Their planning is not as careful and explicit as that in the example previously given.

The following diagram represents the dimensions of creating an exchange relationship just discussed with "X's" representing the example of S and B's contract for ten taxi-cabs.

	Definition of Performances	**Effect of Contingencies**	**Effect of Defective Performances**	**Legal Sanctions**
Explicit and careful	X			
Tacit agreement		X		
Unilateral assumptions			X	
Unawareness of the issue				X

Most larger companies, and many smaller ones, attempt to plan carefully and completely. Important transactions not in the ordinary course of business are handled by a detailed contract. For example, recently the Empire State Building was sold for $65 million. More than 100 attorneys, representing 34 parties, produced a 400 page contract. Another example is found in the agreement of a major rubber company in the United States to give technical assistance to a Japanese firm. Several million dollars were involved and the contract consisted of 88 provisions on 17 pages. The 12 house counsel – lawyers who work for one corporation rather than many clients – interviewed said that all but the smallest businesses carefully planned most transactions of any significance. Corporations have procedures so that particular types of exchanges will be reviewed by their legal and financial departments.

More routine transactions commonly are handled by what can be called standardized planning. A firm will have a set of terms and conditions for purchases, sales, or both printed on the business documents used in these exchanges. Thus the things to be sold and the price may be planned particularly for each transaction, but standard provisions will further elaborate the performances and cover the other subjects of planning. Typically, these terms and conditions are lengthy and printed in small type on the back of the forms. For example, 24 paragraphs in eight point type are printed on the back of the purchase order form used by the Allis Chalmers Manufacturing Company. The provisions: (1) describe, in part, the performance required, e.g., "DO NOT WELD CASTINGS WITHOUT OUR CONSENT"; (2) plan for the effect of contingencies, e.g., ". . . in the event the Seller suffers delay in performance due to an act of God, war, act of the Government, priorities or allocations, act of the Buyer, fire, flood, strike, sabotage, or other causes beyond Seller's control, the time of completion shall be extended a period of time equal to the period of such delay if the Seller gives the Buyer notice in writing of the cause of any such delay within a reasonable time after the beginning thereof"; (3) plan for the effect of defective performances, e.g., "The buyer, without waiving any

other legal rights, reserves the right to cancel without charge or to postpone deliveries of any of the articles covered by this order which are not shipped in time reasonably to meet said agreed dates"; (4) plan for a legal sanction, e.g., the clause "without waiving any other legal rights," in the example just given.

In larger firms such "boiler plate" provisions are drafted by the house counsel or the firm's outside lawyer. In smaller firms such provisions may be drafted by the industry trade association, may be copied from a competitor, or may be found on forms purchased from a printer. In any event, salesmen and purchasing agents, the operating personnel, typically are unaware of what is said in the fine print on the back of the forms they use. Yet often the normal business patterns will give effect to this standardized planning. For example, purchasing agents may have to use a purchase order form so that all transactions receive a number under the firm's accounting system. Thus, the required accounting record will carry the necessary planning of the exchange relationship printed on its reverse side. If the seller does not object to this planning and accepts the order, the buyer's "fine print" will control. If the seller does object, differences can be settled by negotiation.

This type of standardized planning is very common. Requests for copies of the business documents used in buying and selling were sent to approximately 6,000 manufacturing firms which do business in Wisconsin. Approximately 1,200 replies were received and 850 companies used some type of standardized planning. With only a few exceptions, the firms that did not reply and the 350 that indicated they did not use standardized planning were very small manufacturers such as local bakeries, soft drink bottlers and sausage makers.

While businessmen can and often do carefully and completely plan, it is clear that not all exchanges are neatly rationalized. Although most businessmen think that a clear description of both the seller's and buyer's performances is obvious common sense, they do not always live up to this ideal. The house counsel and the purchasing agent of a medium size manufacturer of automobile parts reported that several times their engineers had committed the company to buy expensive machines without adequate specifications. The engineers had drawn careful specifications as to the type of machine and how it was to be made but had neglected to require that the machine produce specified results. An attorney and an auditor both stated that most contract disputes arise because of ambiguity in the specifications.

Businessmen often prefer to rely on "a man's word" in a brief letter, a handshake, or "common honesty and decency" – even when the transaction involves exposure to serious risks. Seven lawyers from law firms with business practices were interviewed. Five thought that businessmen often entered contracts with only a minimal degree of advance planning.

They complained that businessmen desire to "keep it simple and avoid red tape" even where large amounts of money and significant risks are involved. One stated that he was "sick of being told, 'We can trust old Max,' when the problem is not one of honesty but one of reaching an agreement that both sides understand." Another said that businessmen when bargaining often talk only in pleasant generalities, think they have a contract, but fail to reach agreement on any of the hard, unpleasant questions until forced to do so by a lawyer. Two outside lawyers had different views. One thought that large firms usually planned important exchanges, although he conceded that occasionally matters might be left in a fairly vague state. The other dissenter represents a large utility that commonly buys heavy equipment and buildings. The supplier's employees come on the utility's property to install the equipment or construct the buildings, and they may be injured while there. The utility has been sued by such employees so often that it carefully plans purchases with the assistance of a lawyer so that suppliers take this burden.

Moreover, standardized planning can break down. In the example of such planning previously given, it was assumed that the purchasing agent would use his company's form with its 24 paragraphs printed on the back and that the seller would accept this or object to any provisions he did not like. However, the seller may fail to read the buyer's 24 paragraphs of fine print and may accept the buyer's order on the seller's own acknowledgment-of-order form. Typically this form will have ten to 50 paragraphs favoring the seller, and these provisions are likely to be different from or inconsistent with the buyer's provisions. The seller's acknowledgment form may be received by the buyer and checked by a clerk. She will read the face of the acknowledgment but not the fine print on the back of it because she has neither the time nor ability to analyze the small print on the 100 to 500 forms she must review each day. The face of the acknowledgment – where the goods and the price are specified – is likely to correspond with the face of the purchase order. If it does, the two forms are filed away. At this point, both buyer and seller are likely to assume they have planned an exchange and made a contract. Yet they have done neither, as they are in disagreement about all that appears on the back of their forms. This practice is common enough to have a name. Law teachers call it "the battle of the forms."

Ten of the 12 purchasing agents interviewed said that frequently the provisions on the back of their purchase order and those on the back of a supplier's acknowledgment would differ or be inconsistent. Yet they would assume that the purchase was complete without further action unless one of the supplier's provisions was really objectionable. Moreover, only occasionally would they bother to read the fine print on the back of suppliers' forms. On the other hand, one purchasing agent insists that agreement be reached on the fine print provisions, but he

represents the utility whose lawyer reported that it exercises great care in planning. The other purchasing agent who said that his company did not face a battle of the forms problem, works for a division of one of the largest manufacturing corporations in the United States. Yet the company may have such a problem without recognizing it. The purchasing agent regularly sends a supplier both a purchase order and another form which the supplier is asked to sign and return. The second form states that the supplier accepts the buyer's terms and conditions. The company has sufficient bargaining power to force suppliers to sign and return the form, and the purchasing agent must show one of his firm's auditors such a signed form for every purchase order issued. Yet suppliers frequently return this buyer's form *plus* their own acknowledgment form which has conflicting provisions. The purchasing agent throws away the supplier's form and files his own. Of course, in such a case the supplier has not acquiesced to the buyer's provisions. There is no agreement and no contract.

Sixteen sales managers were asked about the battle of the forms. Nine said that frequently no agreement was reached on which set of fine print was to govern, while seven said that there was no problem. Four of the seven worked for companies whose major customers are the large automobile companies or the large manufacturers of paper products. These customers demand that their terms and conditions govern any purchase, are careful generally to see that suppliers acquiesce, and have the bargaining power to have their way. The other three of the seven sales managers who have no battle of the forms problem, work for manufacturers of special industrial machines. Their firms are careful to reach complete agreement with their customers. Two of these men stressed that they could take no chances because such a large part of their firm's capital is tied up in making any one machine. The other sales manager had been influenced by a law suit against one of his competitors for over a half million dollars. The suit was brought by a customer when the competitor had been unable to deliver a machine and put it in operation on time. The sales manager interviewed said his firm could not guarantee that its machines would work perfectly by a specified time because they are designed to fit the customer's requirements, which may present difficult engineering problems. As a result, contracts are carefully negotiated.

A large manufacturer of packaging materials audited its records to determine how often it had failed to agree on terms and conditions with its customers or had failed to create legally binding contracts. Such failures cause a risk of loss to this firm since the packaging is printed with the customer's design and cannot be salvaged once this is done. The orders for five days in four different years were reviewed. The percentages of orders where no agreement on terms and conditions was reached or no contract was formed were as follows:

1953	75.0%
1954	69.4%
1955	71.5%
1956	59.5%

It is likely that businessmen pay more attention to describing the performances in an exchange than to planning for contingencies or defective performances or to obtaining legal enforceability of their contracts. Even when a purchase order and acknowledgment have conflicting provisions printed on the back, almost always the buyer and seller will be in agreement on what is to be sold and how much is to be paid for it. The lawyers who said businessmen often commit their firms to significant exchanges too casually, stated that the performances would be defined in the brief letter or telephone call; the lawyers objected that nothing else would be covered. Moreover, it is likely that businessmen are least concerned about planning their transactions so that they are legally enforceable contracts.[5] For example, in Wisconsin requirements contracts – contracts to supply a firm's requirements of an item rather than a definite quantity – probably are not legally enforceable. Seven people interviewed reported that their firms regularly used requirements contracts in dealings in Wisconsin. None thought that the lack of legal sanction made any difference. Three of these people were house counsel who knew the Wisconsin law before being interviewed. Another example of a lack of desire for legal sanctions is found in the relationship between automobile manufacturers and their suppliers of parts. The manufacturers draft a carefully planned agreement, but one which is so designed that the supplier will have only minimal, if any, legal rights against the manufacturers. The standard contract used by manufacturers of paper to sell to magazine publishers has a pricing clause which is probably sufficiently vague to make the contract legally unenforceable. The house counsel of one of the largest paper producers said that everyone in the industry is aware of this because of a leading New York case concerning the contract, but that no one cares. Finally, it seems likely that planning for contingencies and defective performances are in-between cases – more likely to occur than planning for a legal sanction, but less likely than a description of performance.

Thus one can conclude that (1) many business exchanges reflect a high degree of planning about the four categories – description, contingencies, defective performances and legal sanction – but (2) many, if not most, exchanges reflect no planning, or only a minimal amount of it, especially concerning legal sanctions and the effect of defective performances. As a

[5] Compare the findings of an empirical study of Connecticut business practices in Comment, "The Statute of Frauds and the Business Community: A Re-Appraisal in Light of Prevailing Practices," *Yale Law Journal*, 66 (1957), pp. 1038–1071.

result, the opportunity for good faith disputes during the life of the exchange relationship often is present.

The adjustment of exchange relationships and the settling of disputes. While a significant amount of creating business exchanges is done on a fairly non-contractual basis, the creation of exchanges usually is far more contractual than the adjustment of such relationships and the settlement of disputes. Exchanges are adjusted when the obligations of one or both parties are modified by agreement during the life of the relationship. For example, the buyer may be allowed to cancel all or part of the goods he has ordered because he no longer needs them; the seller may be paid more than the contract price by the buyer because of unusual changed circumstances. Dispute settlement involves determining whether or not a party has performed as agreed and, if he has not, doing something about it. For example, a court may have to interpret the meaning of a contract, determine what the alleged defaulting party has done and determine what, if any, remedy the aggrieved party is entitled to. Or one party may assert that the other is in default, refuse to proceed with performing the contract and refuse to deal ever again with the alleged defaulter. If the alleged defaulter, who in fact may not be in default, takes no action, the dispute is then "settled."

Business exchanges in non-speculative areas are usually adjusted without dispute. Under the law of contracts, if B orders 1,000 widgets from S at $1.00 each, B must take all 1,000 widgets or be in breach of contract and liable to pay S his expenses up to the time of the breach plus his lost anticipated profit. Yet all ten of the purchasing agents asked about cancellation of orders once placed indicated that they expected to be able to cancel orders freely subject to only an obligation to pay for the seller's major expenses such as scrapped steel.[6] All 17 sales personnel asked reported that they often had to accept cancellation. One said, "You can't ask a man to eat paper [the firm's product] when he has no use for it." A lawyer with many large industrial clients said,

> Often businessmen do not feel they have "a contract" – rather they have "an order." They speak of "cancelling the order" rather than "breaching our contract." When I began practice I referred to order cancellations as breaches of contract, but my clients objected since they do not think of cancellation as wrong. Most clients, in heavy industry at least, believe that there is a right to cancel as part of the buyer-seller relationship. There is a widespread attitude that one can back out of any deal within some very vague limits. Lawyers are often surprised by this attitude.

Disputes are frequently settled without reference to the contract or potential or actual legal sanctions. There is a hesitancy to speak of legal rights or to threaten to sue in these negotiations. Even where the parties

[6] See the case studies on cancellation of contracts in *Harvard Business Review*, 2 (1923–24), pages 238–40, 367–70, 496–502.

have a detailed and carefully planned agreement which indicates what is to happen if, say, the seller fails to deliver on time, often they will never refer to the agreement but will negotiate a solution when the problem arises apparently as if there had never been any original contract. One purchasing agent expressed a common business attitude when he said,

> if something comes up, you get the other man on the telephone and deal with the problem. You don't read legalistic contract clauses at each other if you ever want to do business again. One doesn't run to lawyers if he wants to stay in business because one must behave decently.

Or as one businessman put it, "You can settle any dispute if you keep the lawyers and accountants out of it. They just do not understand the give-and-take needed in business." All of the house counsel interviewed indicated that they are called into the dispute settlement process only after the businessmen have failed to settle matters in their own way. Two indicated that after being called in house counsel at first will only advise the purchasing agent, sales manager or other official involved; not even the house counsel's letterhead is used on communications with the other side until all hope for a peaceful resolution is gone.

Law suits for breach of contract appear to be rare. Only five of the 12 purchasing agents had ever been involved in even a negotiation concerning a contract dispute where both sides were represented by lawyers; only two of ten sales managers had ever gone this far. None had been involved in a case that went through trial. A law firm with more than 40 lawyers and a large commercial practice handles in a year only about six trials concerned with contract problems. Less than 10 per cent of the time of this office is devoted to any type of work related to contracts disputes. Corporations big enough to do business in more than one state tend to sue and be sued in the federal courts. Yet only 2,779 out of 58,293 civil actions filed in the United States District Courts in fiscal year 1961 involved private contracts.[7] During the same period only 3,447 of the 61,138 civil cases filed in the principal trial courts of New York State involved private contracts.[8] The same picture emerges from a review of appellate cases.[9] Mentschikoff has suggested that commercial cases are not brought to the courts either in periods of business prosperity (because buyers unjustifiably reject goods only when prices drop and they can get similar goods

[7] *Annual Report of the Director of the Administrative Office of the United States Courts*, 1961, p. 238.

[8] State of New York, The Judicial Conference, Sixth Annual Report, 1961, pp. 209-11.

[9] My colleague Lawrence M. Friedman has studied the work of the Supreme Court of Wisconsin in contracts cases. He has found that contracts cases reaching that court tend to involve economically-marginal-business and family-economic disputes rather than important commercial transactions. This has been the situation since about the turn of the century. Only during the Civil War period did the court deal with significant numbers of important contracts cases, but this happened against the background of a much simpler and different economic system.

elsewhere at less than the contract price) or in periods of deep depression (because people are unable to come to court or have insufficient assets to satisfy any judgment that might be obtained). Apparently, she adds, it is necessary to have "a kind of middle-sized depression" to bring large numbers of commercial cases to the courts. However, there is little evidence that in even "a kind of middle-sized depression" today's businessmen would use the courts to settle disputes.[10]

At times relatively contractual methods are used to make adjustments in ongoing transactions and to settle disputes. Demands of one side which are deemed unreasonable by the other occasionally are blocked by reference to the terms of the agreement between the parties. The legal position of the parties can influence negotiations even though legal rights or litigation are never mentioned in their discussions; it makes a difference if one is demanding what both concede to be a right or begging for a favor. Now and then a firm may threaten to turn matters over to its attorneys, threaten to sue, commence a suit or even litigate and carry an appeal to the highest court which will hear the matter. Thus, legal sanctions, while not an everyday affair, are not unknown in business.

One can conclude that while detailed planning and legal sanctions play a significant role in some exchanges between businesses, in many business exchanges their role is small.

TENTATIVE EXPLANATIONS

Two questions need to be answered: (A) How can business successfully operate exchange relationships with relatively so little attention to detailed planning or to legal sanctions, and (B) Why does business ever use contract in light of its success without it?

Why are relatively non-contractual practices so common? In most situations contract is not needed.[11] Often its functions are served by other devices. Most problems are avoided without resort to detailed planning or legal sanctions because usually there is little room for honest misunderstandings or good faith differences of opinion about the nature and quality of a seller's performance. Although the parties fail to cover all foreseeable contingencies, they will exercise care to see that both understand the primary obligation on each side. Either products are standardized with an accepted description or specifications are written calling for production to

[10] New York Law Revision Commission, *Hearings on the Uniform Code Commercial Code*, 2 (1954), p. 1391.

[11] The explanation that follows emphasizes a *considered* choice not to plan in detail for all contingencies. However, at times it is clear that businessmen fail to plan because of a lack of sophistication; they simply do not appreciate the risk they are running or they merely follow patterns established in their firm years ago without reexamining these practices in light of current conditions.

certain tolerances or results. Those who write and read specifications are experienced professionals who will know the customs of their industry and those of the industries with which they deal. Consequently, these customs can fill gaps in the express agreements of the parties. Finally, most products can be tested to see if they are what was ordered; typically in manufacturing industry we are not dealing with questions of taste or judgment where people can differ in good faith.

When defaults occur they are not likely to be disastrous because of techniques of risk avoidance or risk spreading. One can deal with firms of good reputation or he may be able to get some form of security to guarantee performance. One can insure against many breaches of contract where the risks justify the costs. Sellers set up reserves for bad debts on their books and can sell some of their accounts receivable. Buyers can place orders with two or more suppliers of the same item so that a default by one will not stop the buyer's assembly lines.

Moreover, contract and contract law are often thought unnecessary because there are many effective non-legal sanctions. Two norms are widely accepted. (1) Commitments are to be honored in almost all situations; one does not welsh on a deal. (2) One ought to produce a good product and stand behind it. Then, too, business units are organized to perform commitments, and internal sanctions will induce performance. For example, sales personnel must face angry customers when there has been a late or defective performance. The salesmen do not enjoy this and will put pressure on the production personnel responsible for the default. If the production personnel default too often, they will be fired. At all levels of the two business units personal relationships across the boundaries of the two organizations exert pressures for conformity to expectations. Salesmen often know purchasing agents well. The same two individuals occupying these roles may have dealt with each other from five to 25 years. Each has something to give the other. Salesmen have gossip about competitors, shortages and price increases to give purchasing agents who treat them well. Salesmen take purchasing agents to dinner, and they give purchasing agents Christmas gifts hoping to improve the chances of making sale. The buyer's engineering staff may work with the seller's engineering staff to solve problems jointly. The seller's engineers may render great assistance, and the buyer's engineers may desire to return the favor by drafting specifications which only the seller can meet. The top executives of the two firms may know each other. They may sit together on government or trade committees. They may know each other socially and even belong to the same country club. The interrelationships may be more formal. Sellers may hold stock in corporations which are important customers; buyers may hold stock in important suppliers. Both buyer and seller may share common directors on their boards. They may share a common financial institution which has financed both units.

The final type of non-legal sanction is the most obvious. Both business units involved in the exchange desire to continue successfully in business and will avoid conduct which might interfere with attaining this goal. One is concerned with both the reaction of the other party in the particular exchange and with his own general business reputation. Obviously, the buyer gains sanctions insofar as the seller wants the particular exchange to be completed. Buyers can withhold part or all of their payments until sellers have performed to their satisfaction. If a seller has a great deal of money tied up in his performance which he must recover quickly, he will go a long way to please the buyer in order to be paid. Moreover, buyers who are dissatisfied may cancel and cause sellers to lose the cost of what they have done up to cancellation. Furthermore, sellers hope for repeat orders, and one gets few of these from unhappy customers. Some industrial buyers go so far as to formalize this sanction by issuing "report cards" rating the performance of each supplier. The supplier rating goes to the top management of the seller organization, and these men can apply internal sanctions to salesmen, production supervisors or product designers if there are too many "D's" or "F's" on the report card.

While it is generally assumed that the customer is always right, the seller may have some counterbalancing sanctions against the buyer. The seller may have obtained a large downpayment from the buyer which he will want to protect. The seller may have an exclusive process which the buyer needs. The seller may be one of the few firms which has the skill to make the item to the tolerances set by the buyer's engineers and within the time available. There are costs and delays involved in turning from a supplier one has dealt with in the past to a new supplier. Then, too, market conditions can change so that a buyer is faced with shortages of critical items. The most extreme example is the post World War II gray market conditions when sellers were rationing goods rather than selling them. Buyers must build up some reserve of good will with suppliers if they face the risk of such shortage and desire good treatment when they occur. Finally, there is reciprocity in buying and selling. A buyer cannot push a supplier too far if that supplier also buys significant quantities of the product made by the buyer.

Not only do the particular business units in a given exchange want to deal with each other again, they also want to deal with other business units in the future. And the way one behaves in a particular transaction, or a series of transactions, will color his general business reputation. Blacklisting can be formal or informal. Buyers who fail to pay their bills on time risk a bad report in credit rating services such as Dun and Bradstreet. Sellers who do not satisfy their customers become the subject of discussion in the gossip exchanged by purchasing agents and salesmen, at meetings of purchasing agents' associations and trade associations, or even at country clubs or social gatherings where members of top management meet. The American

male's habit of debating the merits of new cars carries over to industrial items. Obviously, a poor reputation does not help a firm make sales and may force it to offer great price discounts or added services to remain in business. Furthermore, the habits of unusually demanding buyers become known, and they tend to get no more than they can coerce out of suppliers who choose to deal with them. Thus often contract is not needed as there are alternatives.

Not only are contract and contract law not needed in many situations, their use may have, or may be thought to have, undesirable consequences. Detailed negotiated contracts can get in the way of creating good exchange relationships between business units. If one side insists on a detailed plan, there will be delay while letters are exchanged as the parties try to agree on what should happen if a remote and unlikely contingency occurs. In some cases they may not be able to agree at all on such matters and as a result a sale may be lost to the seller and the buyer may have to search elsewhere for an acceptable supplier. Many businessmen would react by thinking that had no one raised the series of remote and unlikely contingencies all this wasted effort could have been avoided. Even where agreement can be reached at the negotiation stage, carefully planned arrangements may create undesirable exchange relationships between business units. Some businessmen object that in such a carefully worked out relationship one gets performance only to the letter of the contract. Such planning indicates a lack of trust and blunts the demands of friendship, turning a cooperative venture into an antagonistic horse trade. Yet the greater danger perceived by some businessmen is that one would have to perform his side of the bargain to its letter and thus lose what is called "flexibility." Businessmen may welcome a measure of vagueness in the obligations they assume so that they may negotiate matters in light of the actual circumstances.

Adjustment of exchange relationships and dispute settlement by litigation or the threat of it also has many costs. The gain anticipated from using this form of coercion often fails to outweigh these costs, which are both monetary and non-monetary. Threatening to turn matters over to an attorney may cost no more money than postage or a telephone call; yet few are so skilled in making such a threat that it will not cost some deterioration of the relationship between the firms. One businessman said that customers had better not rely on legal rights or threaten to bring a breach of contract law suit against him since he "would not be treated like a criminal" and would fight back with every means available. Clearly actual litigation is even more costly than making threats. Lawyers demand substantial fees from larger business units. A firm's executives often will have to be transported and maintained in another city during the proceedings if, as often is the case, the trial must be held away from the home office. Top management does not travel by Greyhound and stay at the Y.M.C.A. Moreover, there will be the cost of diverting top management, engineers,

and others in the organization from their normal activities. The firm may lose many days work from several key people. The non-monetary costs may be large too. A breach of contract law suit may settle a particular dispute, but such an action often results in a "divorce" ending the "marriage" between the two businesses, since a contract action is likely to carry charges with at least overtones of bad faith. Many executives, moreover, dislike the prospect of being cross-examined in public. Some executives may dislike losing control of a situation by turning the decision-making power over to lawyers. Finally, the law of contract damages may not provide an adequate remedy even if the firm wins the suit; one may get vindication but not much money.

Why do relatively contractual practices ever exist? Although contract is not needed and actually may have negative consequences, businessmen do make some carefully planned contracts, negotiate settlements influenced by their legal rights and commence and defend some breach of contract law suits or arbitration proceedings. In view of the findings and explanation presented to this point, one may ask why. Exchanges are carefully planned when it is thought that planning and a potential legal sanction will have more advantages than disadvantages. Such a judgment may be reached when contract planning serves the internal needs of an organization involved in a business exchange. For example, a fairly detailed contract can serve as a communication device within a large corporation. While the corporation's sales manager and house counsel may work out all the provisions with the customer, its production manager will have to make the product. He must be told what to do and how to handle at least the most obvious contingencies. Moreover, the sales manager may want to remove certain issues from future negotiation by his subordinates. If he puts the matter in the written contract, he may be able to keep his salesmen from making concessions to the customer without first consulting the sales manager. Then the sales manager may be aided in his battles with his firm's financial or engineering departments if the contract calls for certain practices which the sales manager advocates but which the other departments resist. Now the corporation is obligated to a customer to do what the sales manager wants to do; how can the financial or engineering departments insist on anything else?

Also one tends to find a judgment that the gains of contract outweigh the costs where there is a likelihood that significant problems will arise.[12] One factor leading to this conclusion is complexity of the agreed performance over a long period. Another factor is whether or not the degree of injury in case of default is thought to be potentially great. This factor cuts

[12] Even where there is little chance that problems will arise, some businessmen insist that their lawyer review or draft an agreement as a delaying tactic. This gives the businessman time to think about making a commitment if he has doubts about the matter or to look elsewhere for a better deal while still keeping the particular negotiations alive.

two ways. First, a buyer may want to commit a seller to a detailed and legally binding contract, where the consequences of a default by the seller would seriously injure the buyer. For example, the airlines are subject to law suits from the survivors of passengers and to great adverse publicity as a result of crashes. One would expect the airlines to bargain for carefully defined and legally enforceable obligations on the part of the airframe manufacturers when they purchase aircraft. Second, a seller may want to limit his liability for a buyer's damages by a provision in their contract. For example, a manufacturer of air conditioning may deal with motels in the South and Southwest. If this equipment fails in the hot summer months, a motel may lose a great deal of business. The manufacturer may wish to avoid any liability for this type of injury to his customers and may want a contract with a clear disclaimer clause.

Similarly, one uses or threatens to use legal sanctions to settle disputes when other devices will not work and when the gains are thought to outweigh the costs. For example, perhaps the most common type of business contracts case fought all the way through to the appellate courts today is an action for an alleged wrongful termination of a dealer's franchise by a manufacturer. Since the franchise has been terminated, factors such as personal relationships and the desire for future business will have little effect; the cancellation of the franchise indicates they have already failed to maintain the relationship. Nor will a complaining dealer worry about creating a hostile relationship between himself and the manufacturer. Often the dealer has suffered a great financial loss both as to his investment in building and equipment and as to his anticipated future profits. A cancelled automobile dealer's lease on his showroom and shop will continue to run, and his tools for servicing, say, Plymouths cannot be used to service other makes of cars. Moreover, he will have no more new Plymouths to sell. Today there is some chance of winning a law suit for terminating a franchise in bad faith in many states and in the federal courts. Thus, often the dealer chooses to risk the cost of a lawyer's fee because of the chance that he may recover some compensation for his losses.

An "irrational" factor may exert some influence on the decision to use legal sanctions. The man who controls a firm may feel that he or his organization has been made to appear foolish or has been the victim of fraud or bad faith. The law suit may be seen as a vehicle "to get even" although the potential gains, as viewed by an objective observer, are outweighed by the potential costs.

The decision whether or not to use contract – whether the gain exceeds the costs – will be made by the person within the business unit with the power to make it, and it tends to make a difference who he is. People in a sales department oppose contract. Contractual negotiations are just one more hurdle in the way of a sale. Holding a customer to the letter of a

contract is bad for "customer relations." Suing a customer who is not bankrupt and might order again is poor strategy. Purchasing agents and their buyers are less hostile to contracts but regard attention devoted to such matters as a waste of time. In contrast, the financial control department – the treasurer, controller or auditor – leans toward more contractual dealings. Contract is viewed by these people as an organizing tool to control operations in a large organization. It tends to define precisely and to minimize the risks to which the firm is exposed. Outside lawyers – those with many clients – may share this enthusiasm for a more contractual method of dealing. These lawyers are concerned with preventive law – avoiding any possible legal difficulty. They see many unstable and unsuccessful exchange transactions, and so they are aware of, and perhaps overly concerned with, all of the things which can go wrong. Moreover, their job of settling disputes with legal sanctions is much easier if their client has not been overly casual about transaction planning. The inside lawyer, or house counsel, is harder to classify. He is likely to have some sympathy with a more contractual method of dealing. He shares the outside lawyer's "craft urge" to see exchange transactions neat and tidy from a legal standpoint. Since he is more concerned with avoiding and settling disputes than selling goods, he is likely to be less willing to rely on a man's word as the sole sanction than is a salesman. Yet the house counsel is more a part of the organization and more aware of its goals and subject to its internal sanctions. If the potential risks are not too great, he may hesitate to suggest a more contractual procedure to the sales department. He must sell his services to the operating departments, and he must hoard what power he has, expending it on only what he sees as significant issues.

The power to decide that a more contractual method of creating relationships and settling disputes shall be used will be held by different people at different times in different organizations. In most firms the sales department and the purchasing department have a great deal of power to resist contractual procedures or to ignore them if they are formally adopted and to handle disputes their own way. Yet in larger organizations the treasurer and the controller have increasing power to demand both systems and compliance. Occasionally, the house counsel must arbitrate the conflicting positions of these departments; in giving "legal advice" he may make the business judgment necessary regarding the use of contract. At times he may ask for an opinion from an outside law firm to reinforce his own position with the outside firm's prestige.

Obviously, there are other significant variables which influence the degree that contract is used. One is the relative bargaining power or skill of the two business units. Even if the controller of a small supplier succeeds within the firm and creates a contractual system of dealing, there will be no contract if the firm's large customer prefers not to be bound to

anything. Firms that supply General Motors deal as General Motors wants to do business, for the most part. Yet bargaining power is not size or share of the market alone. Even a General Motors may need a particular supplier, at least temporarily. Furthermore, bargaining power may shift as an exchange relationship is first created and then continues. Even a giant firm can find itself bound to a small supplier once production of an essential item begins for there may not be time to turn to another supplier. Also, all of the factors discussed in this paper can be viewed as *components* of bargaining power – for example, the personal relationship between the presidents of the buyer and the seller firms may give a sales manager great power over a purchasing agent who has been instructed to give the seller "every consideration." Another variable relevant to the use of contract is the influence of third parties. The federal government, or a lender of money, may insist that a contract be made in a particular transaction or may influence the decision to assert one's legal rights under a contract.

Contract, then, often plays an important role in business, but other factors are significant. To understand the functions of contract the whole system of conducting exchanges must be explored fully. More types of business communities must be studied, contract litigation must be analyzed to see why the nonlegal sanctions fail to prevent the use of legal sanctions and all of the variables suggested in this paper must be classified more systematically.

Private Legislation and the Duty To Read – Business Run by IBM Machine, the Law of Contracts and Credit Cards

STEWART MACAULAY*

INTRODUCTION

'IT WILL NOT do for a man to enter into a contract, and, when called upon to abide by its conditions, say that he did not read it when he signed it, or did not know what it contained.'[1] This rallying cry often is sounded in contracts and restitution opinions. Sometimes it makes such good sense that it is axiomatic. Yet in common with all grand slogans, there are situations where it just doesn't fit. For example, where the one who signs cannot read and has reason to trust another who tricks him by misreading the document, most courts have thought that the limits of the duty to read and understand have been reached.[2] Undoubtedly courts would find other boundaries to the principle, if asked to do so. For example, a company that manufactures paper uses a purchase order form printed on gray paper. On the back are a number of terms and conditions printed in such light gray ink that they can be seen only by holding the paper at an angle to the light.[3] Clearly, if a court were ever to enforce any of these terms and conditions, it would be marching to some other ideology than 'choice', even 'choice' in one of its more extreme definitions.

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[1] *Sanger v Dun*, 47 Wis. 615, 620 (1879).

[2] See, eg *Bixler v Wright*, 116 Me 133 (1917).

[3] I obtained this purchase order in my survey of business practices related to contracts problems. See S Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *American Sociological Review* 55 (1963).

More difficult are the cases where the words are there in a form more easily read and understood but where the probabilities are very great that only the most suspicious will discover and translate them correctly. This is often true of printed form 'contracts' and procedures for using them which are produced by large corporations to govern what to them are routine transactions.[4] As we know, often these organizations attempt to use contract ideology to legislate privately; sometimes successfully, sometimes not. How then should we decide that one does or does not have a duty to read and understand? . . .

[Eds Note: Part II is omitted; it discusses several examples of the duty to read in the case law, particularly of Wisconsin.]

III. THE UNDERLYING FACTORS

A. General Considerations

It is fairly easy to spin out examples of where the duty to read and understand does and does not take hold. Moreover, some of the relevant dimensions seem obvious. Assuming an arms-length bargain between businessmen who are experienced risk-takers, one of them should not be able to disappoint the other's expectations and likely or actual reliance by asserting, 'Oh, but I didn't read the contract.' The signed document is too useful a form for signaling the closing of a deal to allow such a defense without very strong reasons for upsetting the transaction. Moreover, the magic of the act of signing is well-known; and usually there is reason to assume that the deal was set as written since typically the one does not know of the other's failure to read and understand. On the other hand, at some point there seems good reason to ignore a written contract procured by trickery. Rational planning and risk assumption would not be served by enforcing the part of a contract written in lemon juice which could only be read over the heat of a candle when the one signing had not been informed of the secret. Some business forms and the ways they are used are almost this bad. There is some danger that a judge, temporarily bereft of his common sense, could apply the duty-to-read slogan to what really is close to an invisible ink case and enforce the document as written. It is easy to be swept up in the moralistic attitude of self-reliance in situations where this is demanding conduct more properly classified as paranoid.

[4] See generally 'Note' (1950) 63 *Harvard Law Review* 494.

B. An Organization of Substantive Contract and Legal System Policies

1. The Dimensions of the Substantive Policies.

While it is hard to disagree with this quick explanation of the duty to read and understand, I think much more is involved in the kinds of cases that were offered as examples. The first step toward judgments about the proper results in these cases is to make explicit the major policy considerations necessarily involved. An analytical scheme I find helpful calls for first separating out the substantive policies that contract and restitution may serve and then identifying at least some of the goals related to the proper or efficient operation of the legal system.[5] For example, we might want our legal system to aid the operation of the insurance industry in order to minimize premium costs (a substantive policy), but we also might want our legal system, insofar as reasonably possible, to reflect the policy choices of a community consensus or those made by an elected legislature rather than those of an appointed judge (a system policy).

Substantive policies primarily can be classified on two dimensions. The first concerns a choice of a market or non-market orientation, in which contract law and restitution can either (a) be tools to facilitate the operation of a market economy – focusing on the needs of those exchanging goods, services, labor and capital or (b) serve to blunt the impact of the unregulated market by refusing to recognize some socially undesirable business practices or by giving aid to people or groups seeking to get out

[5] [original fn 18] These classifications were first worked out in S Macaulay, 'Restitution in Context' (1959) 107 *University of Pennsylvania Law Review* 1133; S Macaulay, 'Justice Traynor and the Law of Contracts' (1961) 13 *Stanford Law Review* 812. Recently my colleague John Hetherington refined these classifications in his article, 'Trends in Enterprise Liability: Law and the Unauthorized Agent', which is to appear in the *Stanford Law Review*. I learned much from his article.

My colleague Lawrence M Friedman has dealt with the problem of more or less generalized rules in L Friedman, *Contract Law in America* (Madison, University of Wisconsin Press, 1965), and in L Friedman, 'Law, Rules, and the Interpretation of Written Documents' (1965) 59 *Northwestern University Law Review* 751. In *Contract Law in America*, he describes a continuing trend from abstract rules toward standards that allow the judges to look at the nuances of each case. In my terms, this progression is from rigorous market functioning rules to either transactional or relief-of-hardship approaches. In 'Law, Rules, and the Interpretation of Written Documents', he discusses 'mandatory' and 'discretionary' rules which is one of the dimensions of my classification. Both of the Friedman pieces are of major importance. Both of us owe a good deal to Max Weber.

Social planning policy tends to be carried out by legislation removing a whole area from the domain of contract law-areas 'spin off' for special treatment such as labor law or occupational licensing. This process is the major theme of the Friedman book, and one that is developed brilliantly. For my comments on the possible relevance of contracts ideas after an area has been removed and given special treatment, see S Macaulay, 'Changing a Continuing Relationship Between a Large Corporation and Those Who Deal With It: Automobile Manufacturers, Their Dealers, and the Legal System Part II' (1965) 1965 *Wisconsin Law Review* 740, 848–50.

from under onerous contracts. The second dimension concerns the approaches by which contract law and restitution can proceed, tending toward either (a) relatively precise general rules or (b) a case-by-case approach.[6] This classification yields four primary categories which must be explained in some detail. The categories, and their somewhat arbitrary names, can be represented as follows:

	market goals	**other than market goals**
Generalizing approach ("rules")	market functioning policy	social (or economic) planning policy
Particularistic approach ('Case-by-case')	transactional policy	relief-of-hardship policy

a. *Market functioning policy* calls for rules of general application in relatively specific terms which minimize (but never eliminate) the creative role of judge and jury or administrators. Predictable law is to be preferred to results that satisfy in particular cases. Thus the parties can consider the impact of contract law both in planning their bargains and in settling disputes. Legal results will not turn on vague abstractions such as 'good faith' but on specific conduct such as signing a contract. In addition to certainty, the rules should tend to reward rational assessment of risks in the market and penalize unbusiness-like conduct. One can usefully identify at least three products of market functioning policy: increased self-reliance, rewards to the crafty, and advantages to the operation of bureaucratic organizations.

The duty to read in a fairly strict form carries out the substantive goal. The legal system should enforce contracts 'as written' and ignore pleas that one party did not read or understand, that the parties agreed that some of the written terms would not apply or that additional ones which were never reduced to writing would apply, and that the words used should be read in some unusual fashion, or in light of some general abstraction such as 'reasonableness'. On the basis of common sense but not much evidence, some have assumed that this tack will promote

[6] [original fn 19] Of course, my transactional and market functioning categories differ from the orthodox learning about the meeting of the minds (subjective theory) and the objective theory of contracts. I would view a meeting of the minds approach as entirely a non-market approach; it usually operates as a rationalization for relief-of-hardship. Moreover, there are many kinds of objective theories which fall on the scale that ranges from transactional to market functioning. At one extreme, an objective theory can mean that a contract neither party intended but both appear to have made will be enforced. At the other extreme, transactional policy can call for imposing liability on one who has, without using due care, misled another by his language and conduct, even though the careless person did not "intend" to make a contract. As is apparent from this discussion, my categories are not dichotomies but extreme points on a range: a given rule or standard is *more or less*, say, transactional or market functional, or *more or less*, say, transactional or based on relief-of-hardship.

self-reliance. If one knows he will be legally bound to what he signs, he will take care to protect himself (or so it is said). And this would be a good thing. People will recognize risks, allocate them in their bargains and plan to deal with them rationally. As a result, more bargains will approach the economists' ideal where both leave the bargaining table in a better position than when the negotiations began. Moreover, disputes during the life of the transaction should tend to be minimized since the process of reading and understanding should make clear who is to do what and who is to take what loss if a particular risk occurs. Also where the legal result is clearly that documents will mean what they say, there is less chance that in settlement negotiations one party's rights must be discounted because of the risk of what a jury might do or because of delay.

Such rules reward those who plan and are careful. In one view those who can drive the best bargains, short of gross fraud, are entitled to their winnings. Perhaps one who can slip into a contract with terms highly favorable to himself which are undetected by the other party, is to be praised for his skill rather than censured. This is just good salesmanship. In this view, a bargain is not an exchange of mutual advantage but a game where each party is to maximize his own gains at the expense of the other. Some may feel that the ability to do well in this game is a skill to be rewarded. A strict duty-to-read rule often will help supply this reward.

Another product of market functioning policy – advantages to the operation of bureaucratic organizations – often derives from people being treated as if they had read and understood a written contract even when it is probable they have not done so. Large economic organizations frequently promulgate rules to govern their exchanges with other organizations and individuals. Typically these rules are cast, or can be cast, in the form of a contract. The other unit's representative or the other individual signs a printed form document or accepts a contractual symbol (say, delivery of a document or goods) although he has little chance or incentive to read, understand, bargain to change the rules or do any or all of these things. Larger firms operate this way for a number of reasons. They must deal through a corps of agents in a myriad of transactions. As a result, there is a need to standardize and formalize procedures. On one hand, the large organization must control its agents who deal with the outside world and limit their power to 'give the company away'. These agents are under many pressures to treat their customers as individuals and tailor the particular deal to suit their customers' needs; most obvious is the pressure to make sales to earn commissions or promotions. Also, 'the customer is always right' in the salesman's world. A rigid form contract which the customer must sign without alteration often is thought to be an efficient way to exercise control over salesmen. The customer is 'on notice' of the salesman's limited authority, and the firm wants to avoid being legally bound to expectations its salesman has created by his conduct that

are inconsistent with company policy. On the other hand, the written document signed by the customer becomes the obligation within the larger organization because of the problems of internal communication. It specifies what must be produced or shipped, and it indicates the full extent of future payments to be received and contingent obligations assumed. If a salesman has made a promise inconsistent with the formal written contract which is highly standardized, it is difficult to communicate this to those who must perform and to those who must make plans based on cash flow and risk assumption. Even if the inconsistent promise is communicated, it poses a problem for a rational bureaucratic organization which tends to thrive on routine. Large organizations are helped if they can control and plan their exposure to risks; if they can do so, their accounting and pricing will be more accurate, and they will not have to set up large reserves to cover a host of unpredictable contingencies. Arguably, this kind of certainty will foster their activities in the market which in turn should yield more jobs and more products at lower prices. A rather strict duty to read, rather than attacking the balance of economic power in the society, supports the operations of large organizations that have this power. This tends to promote rational business affairs, whatever the impact on the individual who assumed he could rely on what he was told rather than what he signed. . . .

Usually these bureaucratic considerations are coupled with the self-reliance idea – the large organization can deal through standardized forms and the prudent individual will protect himself by reading and taking appropriate action – although at times the likelihood of self protection is slim indeed. Occasionally, bureaucratic policy is coupled with a requirement designed to help self-reliance. For example, a Virginia statute demands that a written contract be set in a certain size type to be legally enforceable,[7] the *Uniform Commercial Code* requires some warranty disclaimers to be conspicuous to be effective.[8]

b. *Transactional policy*, the second policy category, also seeks to aid the operation of the market, but with a case-by-case strategy rather than by rules that ignore particular circumstances. The courts ought to take steps to carry out the particular transaction brought before them – they should discover the bargain-in-fact and enforce it with appropriate remedies cut to fit the facts of the case. If this discovery is not possible, the court should work out a result involving the least disruption of plans and causing the least amount of reliance loss in light of the situation at the time of the dispute. In short, courts should seek to implement the 'sense of the transaction', and thus solve the problem in the particular case in market terms – assumption of the risk, reasonable reliance, and so on.

[7] [original fn 20] Virginia Code Annotated § 11-4 (1950).
[8] [original fn 21] *Uniform Commercial Code* § 2-316(2).