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Facilitating Incomplete Contracts

Wendy Netter Epstein

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ABSTRACT

Contract law abhors incompleteness. Although no contract can be entirely complete, the idea of a purposefully incomplete or underspecified contract is antithetical to lawyers' ideals of certainty for the parties and for the law. Indeed, contract law is designed to incentivize parties to specifically articulate their intentions. Yet there is a growing body of interdisciplinary work in economics and cognitive psychology demonstrating that highly specified contracts tend to stifle intrinsic motivation and innovation, whereas less-specified contracts—particularly in public-private contracting, IP, and contracting for innovation—can induce higher effort levels and a more cooperative principal-agent relationship than the traditional approach. Nevertheless, there remain both entrenched doctrinal and sociolegal deterrents to drafting less-specified contracts.

This Article argues that the existing doctrinal roadblocks to incomplete contracts are out of step with the normative goals of commercial contracting—promoting efficiency and incentivizing commercial activity. The indefiniteness doctrine and current approaches to contract interpretation, for instance, over-deter the use of incomplete contracting even when it would be efficient. Ultimately, this Article suggests a new doctrinal approach for those contracts where the law should incentivize incomplete contracting, borrowing from principles of constitutional interpretation: dynamic contextualist interpretation. Courts should look not only to party intent at the moment when the contract was formed but should consider how intentions developed during contract performance. Rather than punishing incompleteness, flexibility should guide determinations of validity and questions of interpretation.

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INTRODUCTION

Legal certainty is a central principle for the rule of law. Contract doctrine illustrates the centrality of that principle perhaps more than any other legal field.¹ In the ideal depiction of contracting, two parties negotiate an agreement prior to undertaking performance obligations. Once both parties have consented to the terms of an agreement and have entered into a contract, then the parties perform their obligations because it is in their rational self-interest to do so; otherwise, no contract would have been signed in the first place. If one party absconds and does not meet his contractual obligation, a court can easily determine breach and damages because the terms of the parties' deal were clear and certain.

In this contracting ideal, compliance is the goal. Parties want to be certain that they will get what they contracted for, or at least that

1. See, e.g., Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 882 (2010) ("Uncertainty is generally regarded as being antithetical to efficient business decisionmaking.").

they will be otherwise compensated for a breach. Certainty is the reason parties formally contract rather than informally agree. And it is easy to understand why “[o]ne of the core principles of contract law is the requirement of definiteness.”² In this model, incomplete contracts that fail to give adequate guidance to the parties about their duties and obligations are more likely to result in opportunistic behavior and litigation and make litigation more time consuming and costly if it does result. Thus, lawyers are taught to avoid these drafting pitfalls.³

Even more importantly, courts punish parties who either carelessly or purposefully draft incomplete contracts.⁴ These parties cause systemic costs in litigation that, in the traditional view, could have and should have been easily avoided by better drafting.⁵ A simple sales contract illustrates. Consider a buyer who agrees to purchase one hundred widgets for five dollars per widget in a one-time transaction. The parties negotiate these terms before any obligations accrue and detail the terms in a written contract. If the buyer receives the widgets but does not pay the seller \$500, the questions of breach and damages are entirely straightforward.

But now consider a second contract. Here, one firm partners with another to co-develop new technology, utilizing the strengths of both

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2. Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1643 (2003).
 3. Almost any contract drafting text would provide relevant examples. *See, e.g.*, TINA L. STARK, DRAFTING CONTRACTS: HOW AND WHY LAWYERS DO WHAT THEY DO 19–21 (2007). Searches of the Internet also reveal innumerable sources of advice for transactional lawyers decrying ambiguity and incompleteness. *E.g.*, GONZAGA UNIVERSITY SCHOOL OF LAW, TRANSACTIONAL SKILLS AND PROFESSIONALISM LAB 19–21 (2011), available at <http://macomberlaw.com/wp-content/uploads/2012/01/Transactional-Lab-Course-Materials-20121.pdf> (“Ambiguity is never acceptable. It is the enemy of every drafter.”).
 4. *See, e.g.*, Gregory M. Duhl, *Conscious Ambiguity: Slaying Cerberus in the Interpretation of Contractual Inconsistencies*, 71 U. PITT. L. REV. 71, 71–79 (2009) (discussing *United Rentals, Inc. v. RAM Holdings, Inc.*, 937 A.2d 810 (Del. Ch. 2007) and noting the court’s “message to lawyers that they have a professional and ethical obligation to draft contracts clearly”); *Choi & Triantis, supra* note 1, at 877 (noting the Delaware Chancery Court opinion in *In re IBP* as an example of a court encouraging precise language (citing *In re IBP, Inc. Shareholders Litigation*, 789 A.2d 14, 66 (Del. Ch. 2001))).
 5. *See* Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 268–71, 311 (1985) (arguing that incompleteness and ambiguity are “formulation errors” and that the law should provide incentives for the reduction of such errors); *see also* Duhl, *supra* note 4, at 77 (arguing that “courts should discourage lawyers from drafting intentionally ambiguous contracts”).

entities to build a product that is not yet fully conceived. After development, the parties intend for the product to be jointly marketed and sold worldwide. In this second contract, compliance still matters—a party that makes a relationship-specific investment does not want the other pulling out of the deal—but so do coordination, collaboration, and innovation. By contracting, the parties need to mitigate risk *and* facilitate coordination, all against a backdrop of complexity and uncertainty.

Perhaps the parties could accomplish these goals by drafting a highly detailed contract with extensive control provisions to try to prevent opportunistic behavior.⁶ This is the strategy the law prefers.⁷ But it is not only difficult and costly to accomplish, it may also not be the best or most efficient strategy in certain contexts. Recent interdisciplinary scholarship in economics, psychology, and the law has found that specificity, financial incentives, and control provisions, in general, can signal mistrust and crowd out parties' intrinsic motivation to perform.⁸ Control-based contracting can give the impression that the principal is trying to constrain the agent and does not trust the agent to implicitly deliver skillful or consummate performance.⁹ Agents respond reciprocally to this sort of treatment. An agent who perceives being treated unfairly will in turn react negatively.

In addition, contracts that are highly specified can create cognitive problems. Agents will often adhere to the strict requirements specified in the contract at the sacrifice of furthering the main objective of the deal.¹⁰ Agents do not think for themselves; they merely do what is required.

On the flip side, more flexible contracting has been shown to mitigate these problems. Less-complete contracts that rely on trust and reciprocity rather than control can induce higher effort levels and a more cooperative principal-agent relationship than the traditional approach. They also mitigate the cognitive problems identified in

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6. Control provisions include monitoring and reporting requirements or incentive-based compensation.
 7. Indeed, if the contract is not specific enough, it may be deemed void by the indefiniteness doctrine or may be construed against the drafter if it is too vague. *See infra* Part II.A.
 8. *See infra* Part I.B.
 9. There are many contracts where compliance or perfunctory performance is all that is necessary or desired. This Article, however, focuses on contracts where the principal seeks a higher level of performance from the agent or the parties working together must deliver consummate performance.
 10. These effects are well documented but not well settled. Some of the conflicting data are addressed *infra* Part I.B.

highly detailed contracts. For both behavioral and cognitive reasons, detailed, highly certain contracts may actually lead to greater inefficiency and an increased likelihood of litigation than more incomplete ones.¹¹

Despite much scholarship now suggesting a more flexible contracting approach, however, lengthy and complicated contracts filled with boilerplate and specific financial incentives continue to be commonplace in commercial transactions. This Article explores why incomplete contracting has not taken hold more widely despite its promise. It suggests that the theory is sound. But the law does not embrace the theory. Contract law assumes that incomplete contracts are always undesirable and should always be deterred. Contract doctrine actively disincentivizes parties from writing incomplete, flexible contracts, even when they might be efficiently employed.

This is most obvious in contract law's (renewed) preference for formalist interpretation in contracts between sophisticated entities. Formalist courts prioritize the four corners of the written agreement when confronted with interpretation questions, incentivizing parties to draft more complete contracts *ex ante*. Even contextualist interpretation is somewhat unfriendly to incomplete contracts. Contextualist courts look to evidence outside the contract in an attempt to discern the intent of the parties *at contract execution*. For the most part, though, they ignore the evolution of the relationship post signing—an integral aspect to the success of flexible contracting.¹²

If the normative goal of contract doctrine is to incentivize commercial activity and efficient dealmaking, the doctrinal approach deriding incompleteness is out of step with the goal. This Article suggests instead an approach to contract interpretation that borrows from principles of constitutional interpretation: dynamic contextualist interpretation. Given that less-specified contracts may be efficient, particularly in a variety of commercial contexts, courts reviewing such contracts should treat them more flexibly and liberally. Courts should account for the nature of flexible contracting—that not all decisions will be made *before* contract execution. Deals may evolve over time. Indeed, this may be the most efficient approach. The law assumes

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11. Michal Shur-Ofry & Ofer Tur-Sinai, *Constructive Ambiguity: IP Licenses as a Case Study*, UNIV. MICH. J. L. REFORM (forthcoming) (manuscript at 18–20), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2430638## (suggesting that ambiguous contracts decrease the prospects of litigation in certain circumstances).
 12. In addition, under the Indefiniteness Doctrine, courts will not enforce contracts that are too vague. Canons of construction such as *contra proferentem* (construe against the drafter) also penalize parties choosing to leave contracts less detailed. Professional and commercial norms also deter parties and their lawyers from drafting less-specified contracts. See *infra* Part II.B.

that contracts are static and focuses on the agreement between the parties at execution. But many contracts are not static. They are dynamic, and their meaning evolves as the parties' relationship evolves. Contract doctrine should match this reality. This Article begins to explore how and when that could be accomplished.

The Article proceeds in four parts. Part I rejects the traditional assumption that "good" contracts are *necessarily* detailed and specific. It reviews the growing interdisciplinary body of work suggesting that for both economic and behavioral reasons, commercial parties writing less-specified contracts *ex ante* might engender better contracting results *ex post*. Part II describes why few parties nonetheless take advantage of more flexible contracting forms that might be more efficient. It describes how lawyers are actively disincentivized from writing incomplete contracts by exploring both the doctrinal and sociolegal deterrents to these cooperative methods of contracting. Part III sets out the normative argument. It suggests that contract doctrine creates drafting incentives for transacting parties and that the current matrix is creating the wrong incentives. The right incentives should support commercial activity and generate efficient outcomes. Thus, doctrine should be reformed to better reflect and support these new models of contracting. Finally, Part IV begins to discuss how contract doctrine might be reformed for a particular class of contracts. Courts reviewing purposely relational contracts should not only treat them more flexibly and liberally but should take a dynamic and contextual approach to matters of interpretation. Contracts may have been static and unchanging in the traditional model, but these new forms of purposefully incomplete contracts are dynamic and evolving, and the law should follow suit.

I. FLEXIBLE CONTRACTING CAN BE EFFICIENT

The law's standard assumption is that more complete and unambiguous contracts are better.¹³ But there is a growing body of

13. There are myriad current advocates of detailed contracting, as well. For examples in the public-private contracting context, see, for example, Jody Freeman, *Extending Public Law Norms Through Privatization*, 116 HARV. L. REV. 1285, 1351 (2003) (noting that "there might be considerable agreement between the economic and public law views about the importance of clear and enforceable contractual terms to the success of privatization"); Oliver Hart, *Incomplete Contracts and Public Ownership: Remarks, and an Application to Public-Private Partnerships*, 113 ECON. J. C70 (2003) (noting the prevailing sentiment about government contracting that "any goals—economic or otherwise—can be achieved via a detailed initial contract"); *Developments in the Law: The Law of Prisons: III. A Tale of Two Systems: Cost, Quality, and Accountability in Private Prisons*, 115 HARV. L. REV. 1868, 1887 (2002) ("[T]here is no substitute for performance contracts that encourage quality improvements, effective monitoring, and information gathering and disclosure.").

work that demonstrates the pitfalls of highly specified, control-based contracting. This suggests the merits of less specification and more flexibility. Arguments for *purposefully* less-specified contracts run the gamut from traditional economic arguments centering on transaction cost savings to newer behavioral science research about reciprocity and intrinsic motivation. This Part explores the scholarship on incomplete contracts and suggests that at least where certain deal characteristics are present, less specification and more flexibility might lead to more efficient results than the alternative.¹⁴

But first, a clarification about scope. The term “incomplete contracts” covers a lot of ground in the literature. A contract may be incomplete because of a failure to agree or because of a measured decision to leave terms open for later discussion.¹⁵ A contract may also be incomplete in the sense that parties cannot foresee all possible future states or address all possible contingencies.¹⁶ Indeed, no contract can ever anticipate all future states of the world; hence, in this sense, all contracts are incomplete.¹⁷ Even other contracts are incomplete because the parties choose vague, standard-like conditions when they could have input specific, verifiable conditions.¹⁸ Finally, a

For an example in corporate acquisitions, see Choi & Triantis, *supra* note 1, at 880 (“[T]he existing case law on MAC clauses suggests that they should be drafted not only with specificity, but with quantifiable and easily determined monetary thresholds or descriptions of triggering events.”).

14. This Article does not argue that no parties should ever make the decision to highly specify their agreement and ask the court for a formalist interpretation if disputes arise. Rather, the argument is more nuanced—that certain types of agreements benefit from less-specified drafting and that the law should account for that reality.
15. See, e.g., E. ALLAN FARNSWORTH, I FARNSWORTH ON CONTRACTS § 3.27 (2d ed. 1998). Depending on the degree of the failure to agree, these contracts may be void because of lack of mutual assent, not just indefiniteness.
16. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 92 n.29 (1989) (“A contract may also be incomplete in that it is insensitive to relevant future contingencies.”). A third reason for a contract’s incompleteness is that parties may consciously choose not to address possible future states because of costs associated with doing so. In such situations, it is possible to instead write contracts that define governance structures to deal with contingencies not addressed *ex ante*.
17. Scott, *supra* note 2, at 1641. (“All contracts are incomplete. There are infinite states of the world and the capacities of contracting parties to condition their future performance on each possible state are finite.”).
18. See Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 818 (2006) (examining the choice to use vague terms when precise provisions could have been employed); Choi & Triantis, *supra* note 1, at 879 (considering the use of standards

contract can be incomplete if it fails to make use of control options such as monitoring and reporting requirements or incentive-based compensation.¹⁹

All contracts can be plotted on a multidimensional spectrum that accounts for these characteristics. One axis would cover specification of tasks. A contract that details every step an agent must take to comply with the contract falls at one end, and a contract that simply asks the agent to do the task without further direction marks the other end. A second axis would cover the extent of *ex ante* agreement to terms. One end would be a contract that tries to anticipate every issue on which the parties must agree and details these decisions in the contract. The other end would be a contract that leaves many decisions for future negotiation. A third axis would be control rights, with strong control measures at one end and no control measures at the other. This Article uses the term “incomplete contracts” in a purposely broad sense to mean contracts that fall in the more incomplete section of this three-dimensional spectrum.²⁰ The parties might choose not to outline tasks in significant detail when it was possible to do so, use more standard-like language rather than rule-like language, leave terms for future negotiation, and/or choose not to assert control rights like monitoring or audit rights.²¹ This Article focuses in particular on contracts that are incomplete as a strategic choice—bracketing the issue of incompleteness that results from merely careless or lazy drafting.²²

like best efforts rather than specific metrics); Scott, *supra* note 2, at 1642 (discussing deliberately incomplete contracts that decline to condition performance on specific, verifiable measures); Duhl, *supra* note 4, at 84 (considering ambiguity in best efforts standards).

19. See generally George S. Geis, *An Empirical Examination of Business Outsourcing Transactions*, 96 VA. L. REV. 241, 263–64 (2010) (listing different types of control options); George S. Geis, *The Space Between the Markets and Hierarchies*, 95 VA. L. REV. 99, 110–14 (2009) (discussing agency cost problems in contracting).
20. See, e.g., Mark P. Gergen, *The Use of Open Terms in Contract*, 92 COLUM. L. REV. 997, 999 (1992) (“In economic parlance, the term ‘incomplete contract’ describes any contract short of the ideal of a complete contingent contract . . .”). Importantly, however, for this Article, the term “incomplete contracts” does not allude to deals entirely lacking in detail—just a sense that contracts might be more successful if moved further from the most detailed endpoint on the spectrum.
21. A common characteristic of all of these types of incompleteness or vagueness is that the parties leave broad interpretive discretion to the court if litigation results. See *infra* Part II for further discussion.
22. See, e.g., Duhl, *supra* note 4, at 76 n.29 (“Of course, sloppiness is another cause of ambiguous drafting.”).

The next Sections explore the economic and behavioral arguments in favor of purposefully incomplete or flexible contracts and the contexts in which those strategies might be particularly efficient.

A. Economic Approach to Incomplete Contracts

The economic approach to contracting assumes that parties will contract only when the value of the exchanged performance to the buyer exceeds the cost of performance to the seller. Rational parties enter into a transaction only if it makes them both better off.²³

For law and economics scholars, the question of contract drafting strategy turns on costs: drafting costs, performance costs, and litigation costs, to be specific. Parties will draft contracts that minimize the sum of the costs likely to be incurred at these three stages. In general, *ex ante* specification is thought warranted to the degree that expected litigation costs²⁴ and performance costs incurred as a result of lack of specificity are higher than the cost of drafting.²⁵

Transaction costs associated with drafting choices vary greatly from deal to deal. Less-complicated, shorter-term deals tend to be easier and less costly to detail *ex ante*. Drafting costs are also affected by levels of future uncertainty; in general, the lower the levels of uncertainty, the easier it is to draft a complete contract.²⁶ In addition, variables such as frequency of related transactions affect cost. Economies of scale can decrease per transaction drafting costs.²⁷

How to measure or predict transaction costs is the source of fervent scholarly debate. To the extent that drafting, and even detailed drafting, is far less costly than litigation (accounting for the probability that litigation will result), it makes sense to write detailed contracts.²⁸ Judge Richard Posner is a prominent supporter of *ex ante*

23. *E.g.*, Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 ANN. REV. L. & SOC. SCI. 279, 280 (2006) (“The economic approach begins with the assumption that parties act rationally, within the constraints of their environment, in the sense that they wish to contract if they believe the arrangement will make them better off and not otherwise.”).

24. The idea of litigation costs should account for the probability that litigation will result.

25. *See* Scott, *supra* note 23, at 280.

26. *See* Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1, 18–19 (2009) (noting the grain industry as an example of a low uncertainty industry (citing Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765 (1996))).

27. *Id.*

28. *See, e.g.*, Keith J. Crocker & Kenneth J. Reynolds, *The Efficiency of Incomplete Contracts: An Empirical Analysis of Air Force Engine*

contract specification. He suggests that pre-performance specification generally decreases the chance that a party will act opportunistically during contract performance and that the deal will result in litigation.²⁹ In his view, parties are more likely to work out disputes before litigation if a contract is detailed and specific, as well.³⁰ This makes detailed drafting efficient despite the transaction costs inherent in its undertaking.³¹

In the traditional view, detailed drafting also increases the certainty that the judiciary will get it right should litigation result. Or a different spin on the argument is, if the parties have better information, it is more efficient for the parties to make decisions—and more likely they will get it right—than to ask a court to make the decision in litigation.³² Generally, “[i]n the economic analysis of contracts, the benchmark for contract design (the first-best) is the complete contingent contract that specifies the obligations of the parties in each possible future state of the world.”³³

But not all economists tout the virtues of specific and complete contracting, at least not for all deals. It is fairly uncontroversial that

Procurement, 24 RAND J. ECON. 126, 135 (1993) (noting that parties incorporate the potential for future disputes into their contracting).

29. Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1583–84 (2005). This presumption is challenged by the findings of the behavioral literature. See *infra* Part I.B.
30. *Id.* at 1614 (“When a dispute over the contract’s meaning arises, the parties will first try to resolve it themselves. They will do this not only because of the costs of litigation, but also because of the reputation factor that I discussed earlier: the party demonstrably in the wrong on the interpretive issue will hesitate to force the issue to litigation; he is likely to lose and in any event may acquire a reputation as someone who does not honor his commitments. The more carefully drafted the contract is, the easier it will be for the parties to resolve a dispute over its meaning when the dispute first arises, in other words at the prelitigation stage.”). The next Section will explore the experimental literature that challenges this assumption.
31. Posner also suggests, disapprovingly, that “[d]eliberate ambiguity may be a necessary condition of making the contract; the parties may be unable to agree on certain points yet be content to take their chances on being able to resolve them, with or without judicial intervention, should the need arise.” *Id.* at 1583; see also Jeffrey M. Lipshaw, *Metaphors, Models, and Meaning in Contract Law*, 116 PENN ST. L. REV. 987, 1009 (2012) (noting that parties sometimes use “negotiated ambiguities” to close the deal).
32. See, e.g., Choi & Triantis, *supra* note 1, at 851–52 (noting that “courts . . . are usually less informed than parties themselves,” raising the “prospect of costly judicial error on the back end”).
33. George G. Triantis, *The Efficiency of Vague Contract Terms: A Response to the Schwartz-Scott Theory of U.C.C. Article 2*, 62 LA. L. REV. 1065, 1068 (2002).

a level of incompleteness is preferable where the cost of detailed up-front drafting exceeds expected gains. As in the technology co-development contract described above, it can be costly to draft specific contracts for complex deals against a backdrop of much uncertainty.³⁴ In a traditional cost-benefit analysis, then, the more complicated the deal and the more uncertainty that exists, the more likely it is that *ex ante* detailing does not make sense.³⁵ This is particularly true if lack of specificity does not mean higher likelihood of litigation.³⁶

Others have pointed to the unlikeliness of the decision to litigate over a large commercial transaction as an argument for less-specified drafting. Making the choice to sue is contrary to commercial norms.³⁷ It is costly and can invoke reputational sanctions in dealings with other parties.³⁸ Renegotiation is a more likely result. Against that backdrop, detailed *ex ante* contracting done to decrease the likelihood of litigation or to make litigation less costly makes even less sense.

Still other scholars have pointed to another virtue of incompleteness or vagueness in drafting: because contractual incompleteness increases the cost of litigation for both parties,³⁹ it makes it less likely

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34. *Id.* at 1071; *see also* B. Douglas Bernheim & Michael D. Whinston, *Incomplete Contracts and Strategic Ambiguity*, 88 AM. ECON. REV. 902, 903 (1998) (discussing cases where ambiguity is “often optimal”); Gillian K. Hadfield, *Judicial Competence and the Interpretation of Incomplete Contracts*, 23 J. LEGAL STUD. 159, 159 (1984) (noting that definite terms may be “infeasible”).
35. *See* Badawi, *supra* note 26, at 33 (“[C]ontracts governing infrequent transactions are likely to be more incomplete. This relative incompleteness follows from the higher cost of negotiating additional terms.”).
36. This is one of the main advances from the behavioral literature discussed in Part I.B. The long held assumption that lack of specificity means a worse contracting relationship is not true—at least in certain contexts. *See also* Shur-Ofry & Tur-Sinai, *supra* note 11 (manuscript at 13) (“More important for our purposes, even if ambiguous contracts entail higher litigation costs when litigation actually takes place, there is no evidence of a correlation between the level of ambiguity in a contract and the prospects of such litigation. In fact, our analysis below demonstrates that a *certain* level of ambiguity can actually improve the contract’s capability to serve the parties over time and increase the robustness of their transaction, which in turn may decrease the prospects of litigation.”).
37. Claire A. Hill, *Bargaining in the Shadow of the Lawsuit: A Social Norms Theory of Incomplete Contracts*, 34 DEL. J. CORP. L. 191, 212–16 (2009) (discussing the anti-litigation norm).
38. *Id.*
39. *See infra* Part II.A. In brief, where a contract is complete and unambiguous, a court can resolve allegations of breach as a matter of law. Where there is incompleteness or ambiguity, a court will allow in extrinsic evidence, which can vastly increase the cost of litigation.

that the parties will choose to litigate.⁴⁰ In a recent article, Albert Choi and George Triantis used the corporate acquisitions context to illustrate this point.⁴¹ They found that because both parties would bear considerable risk and cost in litigation, litigation is actually less likely to occur where the contract is incomplete.⁴² Thus, more flexible and less-specified drafting may enhance rather than diminish the efficiency of a deal.

The behavioral evidence explored in the next Section further broadens the scope of efficient incomplete contracts.

B. Behavioral Evidence Touting Incompleteness

The prior Section discussed the standard law and economics approach to incomplete contracts. In the simplest description, incomplete contracts are most likely to be efficient when *ex ante* drafting costs are high either because the transaction is very complex or future states of the world are very uncertain.

But it is now well established that individuals' behavior sometimes deviates from the predictions of self-interest and rationality. Daniel Kahneman, Amos Tversky,⁴³ Richard Thaler,⁴⁴ and others first described a variety of contract relevant behavioral anomalies almost thirty years ago. This Section explores the importance of these behavioral anomalies to incomplete contracting.

1. Experimental and Observational Work

Both experimental and observational research have started to define the limits of the assumption that individuals act solely to further their own self-interests. For instance, experiments have shown that a significant portion of the population tends to return kindness with kindness, even when it is not in an individual's rational self-interest to do so.⁴⁵ This is termed the reciprocity norm. Experiments

40. See Albert Choi & George Triantis, *Completing Contracts in the Shadow of Costly Verification*, 37 J. LEGAL STUD. 503, 507 (2008).

41. Choi & Triantis, *supra* note 1, at 856 (arguing that "vague terms may do a better job than precise terms in promoting the goals of contract design").

42. *Id.* at 854-55.

43. See, e.g., Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979); Amos Tversky & Daniel Kahneman, *The Framing of Decisions and the Psychology of Choice*, 211 SCI. 453 (1981).

44. See, e.g., Richard Thaler, *Toward a Positive Theory of Consumer Choice*, 1 J. ECON. BEHAV. & ORG. 39 (1980).

45. Scott, *supra* note 2, at 1644 (noting experimental results that a significant fraction of individuals are motivated by reciprocity rather than self-interest).

have also found that autonomy boosts intrinsic motivation whereas control can signal distrust and crowd out intrinsic motivation to perform.⁴⁶

Rather than viewing incompleteness only as a cost in the overall equation, this scholarship explores incompleteness as a potential value-enhancing characteristic that can make a contract more efficient. Incompleteness can be a net positive in two general ways. First, it can prompt feelings of trust and reciprocity, whereas a more specific contract can dampen the agents' morale and crowd out intrinsic motivation.⁴⁷ Second, highly detailed contracts can have negative cognitive implications: a detailed contract encourages agents to comply precisely with what is specified to the detriment of implementing the larger purpose of the transaction.⁴⁸ Whereas contracts are sometimes thought of primarily as vehicles to provide legal rights for state enforcement or to spell out requirements for parties for compliance purposes, this research describes how contracts can serve a signaling function. What the contract says can actually change the parties' approach to performance.

There is now robust experimental literature addressing these issues. The first relevant experiments studied the question of whether contract content affects party behavior. The studies found that certain positive social norms can be cultivated through changing contract design.⁴⁹ For example, one study compared the effect of

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46. See Chou et al., *The Devil Is in the Details: Less Specific Contracts Promote Feelings of Autonomy, Intrinsic Motivation and Work Persistence* 5 (unpublished manuscript) (on file with author); see also Edward L. Deci et al., *Facilitating Internalization: The Self-Determination Theory Perspective*, 62 J. PERSONALITY 119, 122 (1994); Wendy S. Grolnick & Richard M. Ryan, *Parent Styles Associated with Children's Self-Regulation and Competence in School*, 81 J. EDUC. PSYCHOL. 143, 144 (1989); Richard M. Ryan & Edward L. Deci, *Self-Determination Theory and the Facilitation of Intrinsic Motivation, Social Development, and Well-Being*, 55 AM. PSYCHOLOGIST 68, 70 (2000).
47. Some have also hypothesized that an insistence on specificity can be a signal of anticipating future litigation.
48. See, e.g., Robert Gibbons & Rebecca Henderson, *What Do Managers Do? Exploring Persistent Performance Differences Among Seemingly Similar Enterprises*, in HANDBOOK OF ORGANIZATIONAL ECONOMICS 680–731 (Robert Gibbons & John Roberts eds., 2013); see also Triantis, *supra* note 33, at 1072 (noting that conditioning reward on specified tasks distorts efforts to those tasks and away from ones the agent might otherwise have undertaken).
49. See Anastasia Danilov & Dirk Sliwka, *Can Contracts Signal Social Norms? Experimental Evidence* 3 (IZA, Discussion Paper No. 7477, 2013) (“[C]ontract choices may signal information about the actions of other agents and thus create indirect effects on behavior.”).

implicit versus explicit contracts on agent behavior.⁵⁰ It found that principals who chose the explicit contract lost on average nine tokens per contract compared to a profit of twenty-six tokens per implicit contract.⁵¹ The difference was attributable to effort levels. The agents' effort level in the implicit contract was 5.2 on average (out of ten), while the effort level in the explicit contract was 2.1 on average.⁵² These results have been confirmed in other related studies.⁵³

Recently, similar results were obtained in a series of experiments in the field of business management.⁵⁴ There, the study set out to determine whether adding more detail and additional clauses to contracts served to “crowd out rapport and undermine trust and cooperation.”⁵⁵ It found a statistically significant correlation between contract completeness and signals of distrust.⁵⁶ In other words, more detailed contracts make the relationship less personal and reduce the parties' expectations of the relationship.⁵⁷ The effect persists after

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50. Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, J. ECON. PERSP., Summer 2000, at 159, 176 (2000).
51. *Id.* at 177.
52. *Id.* Fehr et al. dismiss the possibility that the punishment vs. reward distinction explains the result based on the results of further experiments. *Id.* at 178 (citing Ernst Fehr et al., *Endogenous Incomplete Contracts* 1, 4 (Ctr. for Econ. Studies and Ifo Inst. for Econ. Research, CESifo Working Paper No. 445) available at http://papers.ssrn.com/paper.taf?abstract_id=262015 (testing implicit contracts against fixed rate contracts)).
53. See Scott, *supra* note 2, at 1663 (summarizing studies and explaining that “experimental evidence suggests that incompletely specified contracts that leave space for reciprocation can achieve higher levels of efficiency than more explicit, legally enforceable contracts”); see also Iris Bohnet et al., *More Order with Less Law: On Contract Enforcement, Trust, and Crowding*, 95 AM. POL. SCI. REV. 131, 132 (2001) (finding that incentive contracts decrease cooperation); Bruno S. Frey & Reto Jegen, *Motivation Crowding Theory*, 15 J. ECON. SURVS. 589, 589–91 (2001) (discussing how monetary benefits crowd out “intrinsic motivation”); Mark Lubell & John T. Scholz, *Cooperation, Reciprocity, and the Collective-Action Heuristic*, 45 AM. J. POL. SCI. 160, 160–78 (2001) (finding that use of incentives can crowd out reciprocity).
54. See Eileen Y. Chou et al., *The Relational Costs of Complete Contracts* (June 25, 2011) (unpublished manuscript), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1872569.
55. *Id.* at 4; see also Bohnet et al., *supra* note 53, at 131–32 (discussing the effects of incentive contracts); Edward L. Deci et al., *A Meta-Analytic Review of Experiments Examining the Effects of Extrinsic Rewards on Intrinsic Motivation*, 125 PSYCHOL. BULL. 627, 659 (1999) (noting that “reward contingencies undermine people’s taking responsibility for motivating or regulating themselves”).
56. Chou et al., *supra* note 54, at 12.
57. *Id.* at 4.

negotiation, negatively impacting cooperative behavior during the life of the transaction.⁵⁸

These results are not solely experimental. Similar results have been confirmed in studies of real contracts. For instance, an empirical study of 102 business contractual disputes⁵⁹ coded for provisions designed primarily to exert control and those intended to facilitate coordination.⁶⁰ It tested for a correlation between control provisions and goodwill-based trust and competence-based trust⁶¹ and found that the greater the number of control provisions, the lower the level of goodwill-based trust.⁶² Relatedly, it found that the greater the number of control provisions, the lower the likelihood of continuing the relationship after disputes arose.⁶³ Commercial entities rely on contracts both to facilitate coordination and control, but “including too many control provisions may, ironically, promote opportunistic behavior by inducing a ‘business’ rather than ‘ethical’ framing of the interaction.”⁶⁴ This evidence is in stark contrast to the traditional economic assumption that detailed contracts and extensive control provisions better deter opportunistic behavior.⁶⁵

Why would it be the case that less-explicit contracts prompt better agent performance? Most experiments do little to answer the question.⁶⁶ One theory is that less-specific contracts give agents more autonomy than more specific ones and boost intrinsic motivation.⁶⁷

58. *See id.* at 6–9.

59. Deepak Malhotra & Fabrice Lumineau, *Trust and Collaboration in the Aftermath of Conflict: The Effects of Contract Structure*, 54 ACAD. MGMT. J. 981 (2011).

60. *Id.* at 982.

61. The authors also studied the effect of coordination provisions on trust. *Id.* at 983–84.

62. *Id.* at 990.

63. *Id.* They also found that coordination provisions do not affect goodwill-based trust; yet, the higher the level of coordination provisions, the higher the likelihood of continuing the relationship after a dispute. *Id.*

64. *Id.* at 983.

65. *See also* Deepak Malhotra & J. Keith Murnighan, *The Effects of Contracts on Interpersonal Trust*, 47 ADMIN. SCI. Q., 534, 534–59 (discussing how overly controlling contracts with little room for discretion crowd out trust development).

66. In general, behavioral economics focuses on predicting responses, not determining causation.

67. Chou et al., *supra* note 46, at 4; *see also* Deci, et al., *supra* note 46, at 139–40 (distinguishing between “self-regulated regulation” and “controlled regulation”); Grolnick & Ryan, *supra* note 46, at 151–52 (noting differences in outcomes for autonomous students and students in more controlled settings); Ryan & Deci, *supra* note 46, at 68–76 (discussing self-determination theory).

Specificity in contracts, on the other hand, gives the agent the impression of lack of trust on the part of the principal.

It should be noted, however, that there is much still to be studied on these behavioral responses, and not all research confirms these findings.⁶⁸ A recent experiment conducted in the editing context sought to better understand the effect of specificity and good faith on compliance and performance.⁶⁹ In part, the study confirmed findings in past work—that specificity can lead to “cognitive crowding out” by causing people to focus on the detailed instructions rather than the implications of the overall task.⁷⁰ But it also found that specific instructions can enhance rather than harm performance, particularly in situations where guidance is needed.⁷¹ This same effect is not found under conditions of an ethical dilemma, however.⁷² Thus, one important lesson of this work is that context is very important. The next Section discusses the contexts in which incomplete contracting methods might be particularly efficient.

2. Contexts Ripe for Flexible Contracting

Certain contexts are more likely to lend themselves well to flexible contracting strategies than others. Consider again the two contracts hypothesized in the Introduction. A simple sales contract for widgets would probably not benefit from flexible contracting. Drafting a complete contract is a low cost endeavor, and, assuming a relatively fast delivery, there is likely little risk or uncertainty involved. The sole purpose of entering into a binding contract in a transaction like that is to ensure compliance and to obtain damages if there is

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68. Several studies find positive attributes of specificity, rather than crowding out, including Sergio G. Lazzarini et al., *Order with Some Law: Complementarity Versus Substitution of Formal and Informal Arrangements*, 20 J.L. ECON. & ORG. 261, 290 (2004); and Mary Rigdon, *Trust and Reciprocity in Incentive Contracting*, 70 J. ECON. BEHAV. & ORG. 93, 103 (2009). See also Yuval Feldman, *The Complexity of Disentangling Intrinsic and Extrinsic Compliance Motivations: Theoretical and Empirical Insights from the Behavioral Analysis of Law*, 35 WASH. U. J.L. & POL’Y 11, 45 (2011) (discussing the “crowding out theory”); Eric A. Posner, Book Note, 101 AM. J. INT’L L. 509, 510 (2007) (reviewing ROBERT E. SCOTT & PAUL B STEPHAN, *THE LIMITS OF LEVIATHAN: CONTRACT THEORY AND THE ENFORCEMENT OF INTERNATIONAL LAW* (2011)).
69. Constantine Boussalis et al., *An Experimental Analysis of the Effect of Specificity on Compliance and Performance* 1, 3 (unpublished manuscript) (on file with author).
70. *Id.* at 26.
71. *Id.* at 1–2.
72. *Id.* at 30 (“We find much less evidence of a specificity effect when the context is shifted from specificity conferring guidance to specificity implying an ethical imperative.”).

compliance failure. Detailed contracting is typically sufficient. But the contract where a firm partners with another to co-develop new technology might be a good candidate for the flexible approach.

The following examples describe contracting contexts where scholars have either observed incomplete contracting strategies being successfully employed or have suggested such strategies might be successfully implemented.⁷³ The end of the Section generalizes these results and suggests a typology of contracts where this strategy might best be utilized.

a. Contracting for Innovation

Contracts for innovation generally come about where two parties agree to produce an innovative product—“one whose characteristics, costs, and manufacture, because of uncertainty, cannot be specified ex ante.”⁷⁴ Contracts for innovation require collaboration. Either neither party individually has the capacity to both design and develop the product, or it is more cost effective to collaborate. Typically, the product development process is iterative, requiring cooperation over time and through multiple stages.⁷⁵

Gilson, Sabel, and Scott use as an illustration the Apple–SCI contract⁷⁶ where Apple committed to purchase circuit boards and personal computers from SCI, the specifications of which were to be collaboratively determined. The contract does not set a price for the products, which would have been hard to do since the products were not yet specified, but rather describes a process and a formula by which a price would be set, allowing for bargaining between the parties.

Apple and SCI’s contract utilizes both formal and informal mechanisms. The contract is formal in the sense that Apple agreed to purchase a defined percentage of its logic boards and computer systems from SCI during a three-year period (although it made no purchase commitments after the expiration of that period). And there is a formula by which to determine pricing. But it is also incomplete along many dimensions.

73. While case studies have found some evidence of parties writing more incomplete contracts, there has not yet been any systematic study on this point. Importantly, there is no evidence that incomplete or flexible contracting is occurring at optimal levels. It is a key assumption of this Article that it is not and that it will not occur at optimal levels given current doctrinal constraints.

74. Ronald J. Gilson et al., *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431, 451 (2009).

75. *Id.*

76. *Id.* at 463–67. The authors discuss two additional case studies: an agreement between Deere and Stanadyne and between Warner-Lambert and Ligand. *Id.* at 458–63, 467–71.

Apple does not give specifications for the products it will buy because they have to be developed. It does not even describe the process for coming to a Product Plan in any substantive detail.⁷⁷ Product Plans coming out of the agreement by necessity must respond to changes in technology and be prepared collaboratively.⁷⁸ The contract provides for appointment of a test engineer and for SCI to make its facilities available for inspection, so there are some elements of control.⁷⁹ But much of the agreement is phrased in flexible, collaborative terms.⁸⁰

The authors point out that there are both traditional economic reasons and behavioral reasons that this arrangement works. Economically, the parties are bonded by parallel, relationship-specific investments that increase switching costs.⁸¹ Behaviorally, the authors argue that this type of contract works because the formal contract “complement[s] and support[s] relational governance structures” in the contract.⁸² “[F]ormal contracting operates importantly to facilitate the development of informal contracting structures that police the parties’ expectations of capability, cooperation, and trust.”⁸³

Apple and SCI could have attempted to draft an entirely formal, complete contingent contract, but to do so would have been very difficult and costly. Given the amount of collaboration and trust that is necessary to make such an arrangement a success, specified contracting may also have added relational costs of the sort described in the prior Section.⁸⁴

b. Intellectual Property Licenses

Intellectual Property (“IP”) licenses negotiated between sophisticated parties are another context where scholars have suggested that the use of vague or incomplete terms might be an efficient drafting choice. An IP license allows an owner of IP rights to profit from an invention or creative work by charging a party a fee for the use of the idea. For example, an IP license might give a licensee permission to reproduce the licensor’s trademark on their products or to distribute the licensor’s computer software—for a fee.

77. *Id.* at 465.

78. *Id.*

79. *Id.*

80. *Id.* at 466.

81. *Id.* at 488.

82. *Id.* at 494.

83. *Id.* at 472.

84. Alternatively, the parties could have entered into a purely non-binding deal but chose not to do so. See *infra* Part II.A for further discussion of why agreements are not always self-enforcing.

The parties to IP license agreements are generally sophisticated entities who enter into non-rival agreements for mutual benefit.⁸⁵ There is often a strong collaborative component to these agreements.⁸⁶ For instance, in development agreements for drugs or medical devices, licensors are often required to support licensees in development and securing regulatory approvals.⁸⁷ And in software license agreements, licensors often must provide technical support and training so that the licensees can effectively use the technology.⁸⁸ As in contracts for innovation, IP license agreements also happen against a backdrop of complexity and uncertainty.⁸⁹ Sometimes the licensed technology is still in development or the licensed drug is still undergoing clinical testing and waiting for regulatory approval.⁹⁰

IP license agreements, it follows, should provide fertile ground for the use of flexible contracting. Indeed, there is at least some indication that IP license agreements are incomplete (to a degree) in practice. For instance, IP licenses make use of open standards when it would have been possible to input specific, verifiable conditions. The following are some examples from a recent case study:

*“If a solution for a Severity 2 Error is unavailable immediately, Licensors shall make its **best efforts** to provide an acceptable workaround within a **reasonable time**”;*

*“All Services performed under this Agreement shall be provided in a **professional** and **workmanlike** manner, using **due care**, **consistent with prevailing industry standards**”;*
and

*“Licensor shall continually improve its design and delivery of Services, and implement quality assurance processes and procedures necessary to perform the Services **in accordance with industry standards**”*

85. Shur-Ofry & Tur-Sinai, *supra* note 11 (manuscript at 4).

86. *Id.*

87. *Id.* (manuscript at 28).

88. *Id.*

89. See Christopher Buccafusco & Christopher Sprigman, *Valuing Intellectual Property: An Experiment*, 96 CORNELL L. REV. 1, 17–31 (2010) (discussing the results of an experiment attempting to model the uncertainty and asymmetry in *ex ante* valuing of intellectual property); Christopher Buccafusco & Christopher Sprigman, *The Creativity Effect*, 78 U. CHI. L. REV. 31, 31–52 (2011) (discussing the results of an experiment to model the “creativity effect” valuation anomaly in IP transactions).

90. Shur-Ofry & Tur-Sinai, *supra* note 11 (manuscript at 26).

*“LICENCEE shall launch the Product in the Territory at the earliest commercially reasonable date”*⁹¹

It is also not unusual for parties to IP license agreements to fail to address contingencies.⁹² But like contracts for innovation, while IP licenses might be incomplete or ambiguous in some respects, they use explicit and formal mechanisms as well. This mix of incompleteness with formal mechanisms seems to work well when implemented.⁹³

c. Public-Private Contracting

In a previous article, I argued that the outsourcing of complex government services is an area where detailed, control-based contracts are undesirable (yet still prevalent).⁹⁴ When governments outsource services like running prisons and schools or administering state benefits, they tend to “write contracts that highly specify tasks, contain robust monitoring provisions, and financially reward task compliance.”⁹⁵ But the approach is ill suited for the realities of the government-private entity relationship.⁹⁶ Flexible contracting would likely be better.

For one, it can be difficult to specify *ex ante* what it means to run a good prison or to be successful at welfare administration.⁹⁷ And when governments outsource complex services, they often do so because the private sector is thought to be both more innovative and more efficient.⁹⁸ If the government highly specifies tasks, it leaves little room in which the private entity can innovate or improve processes.⁹⁹ At best, a government that highly specifies tasks can hope to obtain task compliance, but consummate performance that goes above and beyond expectations is unlikely.

91. *Id.* (manuscript at 7) (emphasis in original).

92. *See id.* (manuscript at 15, 22, 34) (providing examples of failures to address contingencies in IP license agreements).

93. Note that the authors focus on incompleteness on the periphery of these transactions. It is unclear that there is sufficient evidence to merit the suggestion that the peripheral-ness of the incompleteness is the salient feature of these contracts.

94. Wendy Netter Epstein, *Public-Private Contracting and the Reciprocity Norm*, AM. UNIV. L. REV. (forthcoming) (manuscript at 7), available at <http://ssrn.com/abstract=2427308>.

95. *Id.* (manuscript at 1).

96. *Id.*

97. *Id.* (manuscript at 28). It might be easy, however, to specify what it means to do a good job at road repair. *Id.* This argument is very context dependent.

98. *Id.* (manuscript at 4).

99. *Id.* (manuscript at 6).

Second, highly specified contracts tend not to work well because markets for these types of services are thin. Control-based contracts work where the agent is either worried about court enforcement or reputational sanctions.¹⁰⁰ Where there are few switching options, both litigation and reputational harms are unlikely.¹⁰¹ Against the backdrop of a thin market, control-based contracts do not dissuade agents from acting opportunistically.¹⁰²

Because one of the primary goals of the contracting relationship is to motivate innovation, this context provides another example where less-detailed contracts might be preferable.¹⁰³

Limited studies focusing on local government outsourcing have found that less-rigid contracts do lead to better results.¹⁰⁴ Nonetheless, detailed contracting seems to be the dominant approach in government outsourcing.¹⁰⁵

*C. Types of Contracts Where Implicit Rather Than Explicit
Drafting May Engender More Efficient Results*

In synthesizing this work, a number of common characteristics emerge.¹⁰⁶ A degree of incompleteness is particularly likely to be efficient where (1) the subject matter is particularly complex, (2) the future is uncertain, (3) market mechanisms do not adequately motivate high-quality agent performance, (4) cooperation between the parties is necessary, and (5) innovation is expected or desired.

First, complexity is a common theme in the examples discussed above. As the Introduction alluded to, specification usually works well in straightforward transactions. For instance, if I contract to buy Smith's car for \$10,000, it makes sense that I should specify the

100. *Id.* (manuscript at 17–18).

101. *Id.*

102. *Id.*

103. *See supra* Part I.B.1 (discussing experiments about motivating consummate performance rather than merely compliance).

104. *See, e.g.*, Sergio Fernandez, Accounting for Performance in Contracting for Services: Are Successful Contractual Relationships Controlled or Managed? 11 (Sept. 2005) (unpublished manuscript), *available at* http://localgov.fsu.edu/readings_papers/Service%20Delivery/Fernandez_Accounting_for_Performance_in_Contracting_Services.doc.

105. There is a need for systematic empirical study in this area, but at least anecdotally, this is assumed to be the case. *See* Epstein, *supra* note 94 (manuscript at 6).

106. All of these contracts exist on a spectrum. This Article does not suggest that all characteristics must be present for more implicit contracts to trump more explicit ones. It simply argues that where more of these characteristics are present, it is more likely that less-specified contracting is efficient.

precise car that is the subject of the transaction, state the price, the delivery date, etc. It is neither particularly difficult nor particularly costly to do so. But more complex transactions are a different story. Complexity is a trait shared by all three contexts discussed above—contracting for innovation, IP licenses, and outsourcing government services. In complex transactions, *ex ante* detailing is particularly likely to be costly. Parties who try to detail complex transactions are more likely to make errors along the way. The counterargument, of course, is that complex transactions are sometimes of the type where the principal especially needs to provide detailed guidance to the agent, so determining where on the incompleteness spectrum a contract should be situated is particularly important.¹⁰⁷

Second, and relatedly, incomplete contracts can be desirable in high-uncertainty transactions. Parties are less likely to be able to predict at the drafting stage exactly how things will play out during contract performance. Trying to do so would result in high cost and potentially high rates of error. In addition to the benefit of minimizing transaction costs, uncertain transactions are more likely to benefit from flexibility.

Third, less-detailed contracting is particularly likely to be efficient when parties contract in a shallow market. Where there is a failure of market mechanisms, traditional control-based mechanisms do not work well. Prompting positive social norms rather than relying on traditional control mechanisms is likely to yield better results.

Fourth, one of the important takeaways of the behavioral scholarship is that incomplete contracting bolsters cooperation between the parties, particularly with the right framing. On the other hand, specificity can send the wrong signals to parties hoping for a collaborative working relationship: signals of mistrust and anticipation of litigation rather than trust and optimism.

Fifth, contracts where innovation is highly valued might benefit from a more flexible approach to contracting. Put another way, traditional, highly detailed contracts are likely to be a good fit when compliance is the main contracting goal and can be easily detected. But highly detailed contracts crowd out intrinsic motivation and at best prompt adherence to the detailed requirements; they are poor motivators of agent innovation. Flexible contracting might be efficient when a contract lacks a central focus of compliance, like in the three examples depicted above.

107. To be clear, this Article does not suggest that contracts should be entirely devoid of guidance to the agent. It simply suggests that on the completeness spectrum, many agreements would benefit from sliding closer to the more incomplete pole.

II. DETERRENTS TO DRAFTING LESS-SPECIFIED CONTRACTS

Given the merits of less-detailed contracting in certain situations, it is puzzling that the approach seems underutilized in the United States.¹⁰⁸ This Part explores the doctrinal and sociolegal deterrents to writing less-detailed contracts—even when efficiency would dictate otherwise.

A. Doctrinal Deterrents

The majority of contracts are never litigated. Particularly in complex commercial deals, there is a norm against litigation.¹⁰⁹ Nonetheless, doctrine provides incentives for drafters, even when the default rules can be changed.¹¹⁰ Particularly sophisticated parties are influenced by the knowledge that contract law penalizes parties that fail to draft certain and specified contracts. This doctrinal choice stems from the traditional view of incompleteness as undesirable.¹¹¹

Contract doctrine can largely be categorized by the enduring struggle between the poles of formalism and contextualism.¹¹² Until the mid-twentieth century, contract interpretation was formalist in the sense that the role of courts in contract disputes was to enforce the deals between parties by looking to the language the parties agreed to in the written document.¹¹³ Courts did little to investigate the fairness of deals or to review evidence of the agreement outside what appeared in the contract. Formalism is a rules-based approach. The normative justifications for formalism are freedom of contract and the virtues of certainty and predictability for the parties.

108. Claire A. Hill & Christopher King, *How Do German Contracts Do as Much with Fewer Words?*, 79 CHI.-KENT L. REV. 889, 894 (2004) (describing the picture of U.S. complex business contracts as “very long,” with “a great deal of explanation, qualification, and limitation in the language,” and “a great deal of ‘legalese’”). *But see* Gilson et al., *supra* note 7, at 451 (discussing characteristics of three American examples of less-detailed business contracts); Shur-Ofry & Tur-Sinai, *supra* note 11 (manuscript at 15) (explaining the importance of less-detailed contracts in IP transactions).

109. Hill, *supra* note 37, at 208.

110. Stephen J. Choi et al., *The Dynamics of Contract Evolution*, 88 N.Y.U. L. REV. 1, 3 (2013).

111. *See, e.g.*, Duhl, *supra* note 4, at 77 (“Part of lawyers’ professional obligation is to draft clear contractual language for their clients.”); Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 871–75 (2000) (arguing for formalist interpretation of contracts).

112. Contextualism is sometimes also referred to as a form of realism.

113. Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493, 499 (2010).

With the advent of the Uniform Commercial Code and the Restatement (Second) of Contracts, contract doctrine became more contextualist. Contextualism is a standards-based approach that gives courts discretion to look outside the four corners of a contract to assess the reasonableness and fairness of the deal, keeping in mind the relative bargaining power of the parties.¹¹⁴ Contextualism's normative goal is to protect the reasonable expectations of the parties. The move to contextualist contract doctrine was not without its critics, particularly in those concerned for the loss of certainty and predictability.

Most recently, in reaction to these concerns, the pendulum has started to swing back again toward formalist contract doctrine. The so-called "neoformalist" movement¹¹⁵—at least amongst scholars,¹¹⁶ but arguably amongst the courts as well¹¹⁷—centers mostly on commercial transactions between sophisticated parties.¹¹⁸ Neoformalists argue that parties prefer courts to interpret contracts literally and not to look at a broader evidence base.¹¹⁹ They also argue that parties are better situated than the court to make decisions about the contract.

Both during the contextualist period and the return of formalism, sophisticated parties engaging in commercial transactions have been held to a different set of rules than others.¹²⁰ Courts presume that

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114. In particular, the Uniform Commercial Code allows for interpreting reference to prior course of dealing, trade usage, and course of performance between the parties to interpret or supplement the contract. U.C.C. § 1-303 (2012); *see also* E. ALLAN FARNSWORTH, *CONTRACTS* 201 (4th ed. 2004).
115. John E. Murray Jr., *Contract Theories and the Rise of Neoformalism*, 71 *FORDHAM L. REV.* 869, 870 (2002).
116. *See, e.g.*, Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *YALE L.J.* 541, 619 (2003) (focusing on business entities).
117. *See supra* note 4 and accompanying text.
118. Schwartz & Scott, *supra* note 116, at 545 (limiting analysis only to business entities that "can be expected to understand how to make business contracts").
119. *See* Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 *YALE L.J.* 926, 932 (2010) ("[B]oth the available evidence and prevailing judicial practice support the claim that sophisticated parties prefer textualist interpretation.").
120. Miller, *supra* note 113, at 501 ("Increasingly, sophisticated parties are held to a different set of rules . . . For them, formalism prevails."); Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co., 660 N.E.2d 415, 421 (N.Y. 1995) ("If [sophisticated parties] are dissatisfied with the consequences of their agreement, 'the time to say so [was] at the bargaining table.'" (quoting *Maxton Builders, Inc. v. Lo Galbo*, 502 N.E.2d 184, 189 (N.Y. 1986))).

sophisticated parties negotiate their deals thoroughly; that what the contract says is what the contract means; and that had the parties wanted different terms, they would have included those terms in the agreement. Particularly for sophisticated parties, formalism has been enduring in contract law. And the message to sophisticated parties in a formalist regime is “draft contracts clearly.”¹²¹

With this as background, I explore in the next subparts the doctrinal deterrents to drafting incomplete contracts and the ways in which contract doctrine dissuades parties from choosing to draft purposely incomplete contracts.

1. Indefiniteness Doctrine

The clearest impediment to less-specified contracts is the indefiniteness doctrine. The indefiniteness doctrine holds a contract unenforceable if its terms are too indefinite. According to the formulation in the Restatement (Second) of Contracts,¹²² the terms of a contract must be “reasonably certain” in the sense that they must “provide a basis for determining the existence of a breach and for giving an appropriate remedy.”¹²³ The premise is that a “contract” that leaves fundamental parts of the deal undefined is not a contract at all. The parties must not have intended for it to be binding.¹²⁴ With the indefiniteness doctrine, the law seeks to deter parties from drafting incomplete contracts.

In the contextual approach to contract law, only truly material terms must be definite for the court to find that a contract exists.¹²⁵ Courts will fill gaps if there are holes in nonmaterial (or peripheral) aspects of the deal. If a court determines that a document (or an oral agreement) is too uncertain to be considered an enforceable contract, however, it will leave the parties as it found them.

For many years, scholars assumed that the indefiniteness doctrine was essentially dead because of the modern promise to liberally fill

121. Duhl, *supra* note 4, at 76.

122. Contract doctrine varies by state but the Restatement Second is a good enough proxy for purposes of this Article. *See* RESTATEMENT (SECOND) OF CONTRACTS (1981) [hereinafter RESTATEMENT].

123. *Id.* at § 33; *see also* U.C.C. §§ 2-204(3), 2-305 (2012) (allowing for indefinite and open terms); Daniel P. O’Gorman, *The Restatement (Second) of Contracts’ Reasonably Certain Terms Requirement: A Model of Neoclassical Contract Law and a Model of Confusion and Inconsistency*, 36 U. HAW. L. REV. 169, 172 (2014) (discussing the requirement for “reasonably certain” terms in the Restatement (Second) of Contracts).

124. The assumption that a contract lacking in specificity is not meant to be binding is tenuous at best. *See supra* Part I.

125. For instance, the Uniform Commercial Code requires quantity be specified for a contract to exist, but allows courts to assign a reasonable price if one is not specified by the parties. *See* U.C.C. § 2-305 (2012).

gaps.¹²⁶ But a recent study demonstrated that the doctrine lives on, and there is not only “a surprisingly high volume of litigation” on indefiniteness, but “[i]n literally dozens of cases, American courts dismiss claims for breach of contract on the grounds of indefiniteness, often without granting any relief to the disappointed promisee.”¹²⁷ These findings are consistent with the observation that while the U.C.C. and Restatement (Second) are ostensibly contextualist, many courts still favor a formalist approach, particularly for sophisticated parties.

From the perspective of parties at the drafting stage, the indefiniteness doctrine imparts risk for both sides if litigation ultimately results and a court refuses to enforce an indefinite contract. It will almost always be unclear at the contract drafting stage which party would be penalized if a court ultimately finds the contract to be unenforceable. Accordingly, both parties have an incentive to ensure that a court will find the agreement to be binding, and to do that, the agreement must be sufficiently definite.

Parties could, on the other hand, enter into agreements that rely exclusively on nonlegal sanctions. If nonlegal sanctions are always effective and court enforcement unnecessary, the indefiniteness doctrine is less problematic. Reputation, industry norms, and future business prospects are sometimes sufficient to constrain behavior,¹²⁸ but not always. For instance, nonlegal norms do not function particularly well in industries “that involve infrequent and uncertain transactions.”¹²⁹ More generally, a contract involves a promise to do something in the future when the future is unknown.¹³⁰ When a party must make a relationship-specific investment, it is risky to take a chance on an agreement without the coercive power of the state to back it up. Absent the ability to litigate and seek damages, a party is vulnerable to exploitation if the other party fails to perform its end of the bargain. The prospect of formal enforcement is particularly necessary to encourage efficient contracting with new and untested

126. George S. Geis, *An Embedded Options Theory of Indefinite Contracts*, 90 MINN. L. REV. 1664, 1666 (2006) (“Conventional wisdom says that the indefiniteness doctrine is dead—or at least in its waning hours.”).

127. Scott, *supra* note 2, at 1643–44; *see also* Geis, *supra* note 126, at 1684–85 (citing data to show that “if anything, judicial encounters with the indefiniteness doctrine may be increasing”).

128. *See, e.g.*, Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1737–38 (2001) (discussing expulsion from trade associations as one constraint on behavior).

129. *See* Badawi, *supra* note 26, at 1.

130. *See, e.g.*, Scott, *supra* note 23, at 282 (“The intertemporal aspect of transactions makes contract law’s strict liability highly salient.”).

business partners and in industries where market mechanisms do not function well.¹³¹

2. Rules of Interpretation

Canons of contract interpretation also disincentivize flexible contracting. How courts interpret contracts matters to parties. A high percentage of contract-related litigation concerns questions of interpretation.¹³²

Contract interpretation generally focuses on discerning the intent of the parties at contract formation. There is no single hard-and-fast rule of contract interpretation.¹³³ In general, though, formalist courts will look to the contract language (the four corners of the document) as the best evidence of party intent. Contextualist courts, on the other hand, take a broader approach and will consider extrinsic evidence.

Contract interpretation rules raise two particular problems from the perspective of the parties at the drafting stage wishing to draft less-specified contracts: (1) some canons of interpretation are intentionally punitive to incompleteness or ambiguity, purposely disincentivizing flexible contracting; and (2) court focus on ascertaining the intent of the parties at execution rewards those that have worked out all of the details at execution, not those intending to evolve their agreement over time.

First, the doctrine most obviously punitive to ambiguity is the doctrine of *contra proferentem*, or construe against the drafter.¹³⁴ It suggests that contract provisions that are ambiguous on their face should be construed to benefit the non-drafting party and to punish the drafting party. The theory is that the drafting party, usually the party with greater bargaining power, is in a better position to use clear language. The doctrine has its genesis in the insurance context

131. See Simon Johnson et al., *Courts and Relational Contracts*, 18 J.L. ECON. & ORGAN. 221, 221 (2002); see also Badawi, *supra* note 26, at 40 (discussing “increased reliance on a formal dispute resolution system as a consequence of larger group size and decreased heterogeneity”); Scott, *supra* note 23, at 286 (“[I]nformal enforcement mechanisms . . . are less effective in controlling complex, interactive relationships.”) (citation omitted); Nathan Nunn, *Relationship-Specificity, Incomplete Contracts, and the Pattern of Trade*, 122 Q. J. ECON. 569, 570 (2007) (noting that “countries with better contract enforcement” succeed in “industries for which relationship-specific investments are most important”).

132. See Schwartz & Scott, *supra* note 116, at 547 (discussing how courts “cannot enforce contracts . . . without a theory of interpretation”).

133. For a good description of contract doctrine and the canons of contract interpretation, see ARTHUR L. CORBIN, CORBIN ON CONTRACTS: A COMPREHENSIVE TREATISE ON THE WORKING RULES OF CONTRACT LAW (Rev. ed., 1993).

134. See RESTATEMENT, *supra* note 122, at § 206.

where courts wanted to prevent insurers from purposely using vague language in their policies to later argue for an interpretation favorable to the insurer.¹³⁵ *Contra proferentem* is an obvious manifestation of the law's goal to incentivize complete contracts. While *contra proferentem* does still arise in litigation with some frequency, it is infrequently applied in contracts between two sophisticated parties, where both parties likely had or could have had a hand in drafting.¹³⁶

Formalist contract interpretation is also punitive to incomplete drafting. And in matters of interpretation concerning two sophisticated business entities, courts are likely to be more formalist in approach than contextualist.¹³⁷ Formalist interpretation places great weight on the content of the written agreement, encouraging parties to be as complete as possible in drafting the agreement.¹³⁸ It is marked by a strong parol evidence rule, which states that a final integrated agreement cannot be contradicted by extrinsic evidence in litigation. And "the absence of a written term is taken to imply that the parties reached no agreement over some contingency, and the contract is enforced accordingly."¹³⁹ Formalist contract interpretation is highly problematic for parties who might otherwise consider using a more incomplete contract.

Also, some scholars have suggested that contract doctrine should go even further to penalize parties for writing incomplete contracts. Ayres and Gertner, for instance, have suggested that courts should adopt default rules to fill gaps in contracts that the parties would *not* want. This will create incentives for parties to reveal information during contract negotiation and write complete contracts.¹⁴⁰

135. See Michelle E. Boardman, *Contra Proferentem: The Allure of Ambiguous Boilerplate*, 104 MICH. L. REV. 1105, 1107 (2006).

136. The existence of the doctrine furthers the notion that ambiguity and incompleteness are disfavored even though its practical effect is limited.

137. See Miller, *supra* note 113, at 495–96.

138. See Schwartz & Scott, *supra* note 116, at 549; see also Chunlin Leonhard, *Beyond the Four Corners of a Written Contract: A Global Challenge to U.S. Contract Law*, 21 PACE INT'L L. REV. 1, 2 (2009) ("U.S. courts will generally refuse to look beyond the four corners of the written contract."); Badawi, *supra* note 26, at 33–34 ("In more formal regimes, where judges and arbitrators are likely to put more effort into discerning the meaning of contract terms before turning to extrinsic evidence, parties will have an incentive to devote more resources to contract drafting because it is more likely that the terms of the contract will have an effect on the outcome of any litigation that arises.").

139. Hadfield, *supra* note 34, at 161.

140. See Ayres & Gertner, *supra* note 16, at 97; Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1593 (1999).

The law's focus on ascertaining party intent at contract execution, both in formalist and contextualist regimes, also disincentivizes flexible contracting.¹⁴¹ As discussed in Part I, flexible contracting might be most appropriate when *ex ante* detailing is hard to do and the future is particularly uncertain. The concept is that the parties will collaborate and evolve their agreement over time. Because contract interpretation focuses on contract execution rather than considering the evolution of the parties' agreement, there is a high probability of error in adjudication. Putting aside whether courts are good at ascertaining intent in the first place, there is an even higher probability of error when courts are not asking the right question.

For a variety of reasons, then, parties concerned about *ex post* interpretation issues have incentives *ex ante* to be detailed and specific in their contracting. This is particularly true under a formalist regime that places much significance on the four corners of the contract, but it is true even with contextualist courts seeking to ascertain the intent of the parties at contract execution.¹⁴²

B. Sociolegal Deterrents

Scholars have long recognized that the law “is not an autonomous system, but an integral part of the social life of a community.”¹⁴³ In addition to doctrine, professional and commercial norms provide powerful incentives that affect party behavior.¹⁴⁴ There are a number of sociolegal deterrents that affect drafting decisions.

141. Choi et al., *supra* note 110, at 2 (“Scholars frequently assume that parties draft bespoke contracts that serve the needs of specific transactions.”).

142. For the most part, contract rules are default rules that the parties could contract around. They nonetheless create incentives for parties. *See infra* Part III.

143. Jody S. Kraus, *Legal Design and the Evolution of Commercial Norms*, 26 J. LEGAL STUD. 377, 381 (1997) (quoting E. Donald Elliott, *The Evolutionary Tradition in Jurisprudence*, 85 COLUM. L. REV. 38, 40 (1985), which traces the notion back to scholar Friedrich Karl von Savigny).

144. *See* Melvin A. Eisenberg, *Corporate Law and Social Norms*, 99 COLUM. L. REV. 1253, 1262 (1999) (describing the process by which social norms associated with occupational roles are internalized as extremely important to the legal and economic literature, although under-analyzed); *see also* Badawi, *supra* note 26, at 38 (“One of the great insights of the literature on law and social norms is that belief systems and community norms can provide powerful behavioral incentives.”) (footnote omitted); *cf.* Robert D. Cooter, *Inventing Market Property: The Land Courts of Papua New Guinea*, 25 LAW. & SOC’Y REV. 759, 777 (1991) (discussing community norms that enforce legal transactions); Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 STAN. L. REV. 623, 668 (1986)

It helps to better understand the context in which many of the target contracts—those for which flexible contracting might be more efficient—arise. The ideal of two parties negotiating the terms of a deal and then sitting down to put pen to paper is not commonplace in practice. Rather, as George Triantis recently described:

Rarely is a contract in any given transaction made from whole cloth and, despite the sentiments of some lawyers, contracts are not creative works of literature. Rather than writing from scratch, lawyers typically reuse contract provisions from previous transactions. Individually and within their firms, they store and retrieve documents from past deals and follow procedures for standardizing best practices for different types of transactions.¹⁴⁵

The first reality is that lawyers are often copying large parts of contracts from one transaction to the next. Given that most large deals have long, detailed contracts with lots of boilerplate provisions, there is a certain momentum, or “stickiness,”¹⁴⁶ to the detailed contracting method.¹⁴⁷

The template, in other words, is lengthy and detailed at the start. But then comes the customization. Contracts (and the lawyers who draft them) are often judged by their thoroughness.¹⁴⁸ Claire Hill suggests that, particularly when sophisticated entities negotiate large transactions, the norm in the U.S. is to custom tailor to the hilt. Parties start with the typical detailed framework and boilerplate clauses and then do everything they can to anticipate what might go wrong or how the other party might try to act opportunistically.¹⁴⁹

(noting that neighbors will cooperate with one another even when “inconsistent with formal legal rules”).

145. George G. Triantis, *Improving Contract Quality: Modularity, Technology, and Innovation in Contract Design*, 18 STAN. J.L. BUS. & FIN. 177, 186 (2013).

146. See *supra* note 140 and accompanying text; Triantis, *supra* note 145, at 194 (“As legal scholars have noted, standard contract terms are often sticky or locked-in practices.”); see also Kenneth A. Adams, *Dysfunction in Contract Drafting: The Causes and a Cure*, 15 TRANSACTIONS: TENN. J. BUS. L. 317, 318 (2013) (discussing the reasons that lawyers resist revising standard language).

147. See also Choi et al., *supra* note 110 at 3 (noting that “the majority of . . . contracts are modifications of existing templates, including older contracts or forms”).

148. Thoroughness is assumed to be a positive attribute. *But see supra* Part I.

149. This view of the role of a lawyer in drafting comes in part from the norms of the profession generally, which view lawyers as more aggressive and competitive than other professionals.

Abiding by this norm of custom tailoring, Hill says, “will never engender criticism, but if there should be a dispute over the contract language later on, not having abided by the norm may very well be punished”¹⁵⁰ The question will be asked, “[C]ould more care have clarified the language sufficiently to avoid the dispute (or to easily prevail at litigation)?”¹⁵¹

Young lawyers receive the message very clearly. They must not only pay attention to clarity in drafting contracts, but if it later turns out that they did not anticipate a contingency and it harms the client, their professional advancement will suffer.¹⁵² This norm likely stems from the traditional assumption that imprecise contracts cause litigation.

The message that clear and detailed contracting is the ideal starts as early as law school. In law school drafting classes, law students are taught that “good” contracts are highly detailed, consistent, unambiguous, and anticipate future states of the world.¹⁵³ While no contract can be entirely complete, and on this point there is much agreement, completeness is nonetheless a goal toward which to strive. There is cost associated with writing highly specified contracts,¹⁵⁴ but lawyers are taught that with that cost should come many benefits, such as more certainty for the parties and a lower likelihood that the relationship will break down. Indeed, it would be difficult to find too many lawyers who would advise their clients that a contract should be less detailed.¹⁵⁵ One scholar has even suggested that lawyers are ethically obligated to “draft clear contractual language for their clients.”¹⁵⁶

150. Hill & King, *supra* note 108, at 902.

151. *Id.*; see also *id.* at 899 (“The effect on contract documentation is cumulative: Parties in the U.S. start with ‘forms’ that are already quite cluttered with language from previous deals in which the forms were used, and clutter them further.”).

152. Hill, *supra* note 37, at 205.

153. See generally STARK, *supra* note 3 (devoting considerable attention to clarity and avoiding ambiguity).

154. Admittedly, that cost may be reduced by the reuse of detailed form contracts and boilerplate.

155. In prior work, I advocated for less-detailed contracting in the government outsourcing context. Epstein, *supra* note 94. I was met with skepticism along these lines: What lawyer would ever advise her client to draft a less-detailed contract? Those questions prompted this Article. It seems intuitively true that lawyers would not advocate for less detail, but perhaps they should.

156. Duhl, *supra* note 4, at 77.

Client expectations also help to sustain these norms. Clients expect detailed and thorough contracts.¹⁵⁷ Having little other means for judging a contract at execution, clients equate length and thoroughness with good lawyering. And because transactional lawyers also play the role of adviser, there is a premium on certainty.

Finally, particularly at the large law firms that handle most of the contract drafting for large, sophisticated entities, compensation is based on hourly billable rates.¹⁵⁸ Lawyers get paid for the amount of time they spend negotiating and drafting contracts. They therefore have little incentive to suggest that clients use more standard-like, less-detailed contracts.

III. CONTRACT DOCTRINE SHOULD, BUT FAILS TO, SUPPORT INTENTIONALLY INCOMPLETE DRAFTING

Contract doctrine should better reflect the evolution of our understanding of incomplete contracts. Current doctrine assumes that incomplete contracts result from error and universally deters parties from drafting such contracts. We now know that in certain contexts, incomplete contracts are desirable and efficient. A one-size-fits-all doctrinal approach to contract drafting no longer makes sense.

There is a vast literature on incomplete contracts that precedes this Article. This scholarship can loosely be categorized into two (not mutually exclusive) camps. The first camp furthers the traditional argument that incomplete contracts are undesirable and parties should be deterred from drafting them. Contract law should therefore be formalist.¹⁵⁹ The second camp argues that incomplete contracts can be desirable. Scholars observe that parties sometimes enter into incomplete contracts despite the deterrent effect of doctrine and posit

157. *Id.* at 79. (decrying conscious ambiguity and arguing that lawyers have professional and ethical obligations to draft contracts clearly but not addressing the merits of flexible contracting as discussed in this Article).

158. In a mid-size or small firm, it is common to negotiate a flat fee for a project, particularly for smaller clients. But the large firms still handle a high percentage of drafting the type of deals on which this Article focuses.

159. *See, e.g.,* Scott, *supra* note 111, at 852 (“All contracts are relational, complex and subjective. But contract law, whether we like it or not, is none of those things. Contract law is formal, simple, and (returning to Macneil’s terminology) *classical*.”); Omri Ben-Shahar, *The Tentative Case Against Flexibility in Commercial Law*, 66 U. CHI. L. REV. 781, 793 (1999) (“The greater the courts’ allegiance to the writing, the more careful will the parties be in drafting the written document.”); Frederick Schauer, *Formalism*, 97 YALE L.J. 509 (1988) (reviewing scholarship on formalism and proposing a doctrinal return to it); Duhl, *supra* note 4, at 77 (arguing that lawyers are ethically obligated to draft clear and definite contracts).

that the reason is that these contracts are self-enforcing.¹⁶⁰ In other words, doctrine is irrelevant because nonlegal norms will govern the relationships. These two camps are like ships passing in the night.

This is the first Article to bridge the gap. Like the first camp, it notes that doctrine has incentive effects on drafting. But like the second camp, it suggests that incomplete contracts are not always undesirable and are sometimes the more efficient choice. Doctrine can therefore over-deter the use of incomplete contracts.

A. Doctrine Has Incentive Effects on Drafting

One of the great advances of the law and economics movement was to shift scholarly attention from *ex post* judicial decision making to the *ex ante* perspective.¹⁶¹ Why do parties enter into contracts and what affects their choices to do so? Scholars now generally agree that litigation decisions and legal doctrine in general create incentives for parties at the drafting stage.¹⁶² Transactional lawyers draft contracts to avoid litigation or to give their clients the best hopes of winning in litigation should it result. Contract doctrine presently deters parties

160. See, e.g., Bernstein, *supra* note 128, at 1745–54 (discussing the importance of reputation and non-legal sanctions in the cotton industry); Scott, *supra* note 2, at 1644 (“Another answer is that these agreements may be self-enforcing.”); Robert E. Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CAL. L. REV. 2005, 2039–42 (1987) (describing self-enforcing agreements); Oliver E. Williamson, *Assessing Contract*, 1 J.L. ECON. & ORG. 177, 183 (1985) (“[C]ontract execution goes efficiently to completion because [some] promises . . . are . . . self-enforcing.”); Mark P. Gergen, *A Theory of Self-Help Remedies in Contract*, 89 B.U. L. REV. 1397, 1401 (2009) (discussing reasons why parties are hesitant to use litigation to enforce contracts).

161. See Scott, *supra* note 111, at 849 (noting that *ex ante* efficiency is “designed to protect (and even improve) the utility of the set of contractual signals for future parties”).

162. See, e.g., Choi & Triantis, *supra* note 1, at 851 (arguing that the outcome of MAC clause litigation should be “of great interest to contract scholars” because it will lead to “significant revision or redrafting of these provisions in the next generation of contracts”); Choi et al., *supra* note 110, at 7 (“When contracting parties abandon a standard and adopt a new form contract, they take the risk that courts will interpret their terms in an unpredictable way.”); Avery Wiener Katz, *The Economics of Form and Substance in Contract Interpretation*, 104 COLUM. L. REV. 496, 497 (2004) (stating that interpretation doctrine “significantly shape[s] the ways in which the contract provides incentives and allocates risk”); Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 264, 268–71, 311 (1985) (noting that the judicial approach to contract interpretation has “far-reaching feedback effects on the operation of the *ex ante* contractual signalling [sic] system”).

from using flexible forms of contracting.¹⁶³ Parties can signal to a court via contract language a preference for more contextual interpretation in litigation. However, because of the norms discussed in Part II.B and the stickiness of default rules, such decisions are rare.¹⁶⁴ Doctrinal reform has the potential to change the incentives, to spur rather than deter the efficient use of incomplete forms of contracting.¹⁶⁵

Critics suggest that transactional lawyers do not pay attention to doctrine and that it has little effect on contract drafting choices. Litigators and transactional lawyers do not mix much in practice, form contracts do not change much over time, and parties assume contracts will never be litigated. It may be true that transactional lawyers and litigators live in very separate worlds.¹⁶⁶ However, “it surely cannot be the case that the legal rules have no effect on the conduct of commercial activity generally.”¹⁶⁷ We would not see so much customization of contracts if transactional lawyers truly were not thinking about the prospects of later litigation.¹⁶⁸ And there is evidence that contract language (even the so-called “boilerplate”) is sensitive to shocks such as doctrinal changes or changes in the marketplace.¹⁶⁹ So transactional lawyers do not just have their heads in the sand.

As for the argument that agreements are self-enforcing—or that parties look to enforcement mechanisms outside the court system—

163. *See infra* Part II.A.

164. *See generally* Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 611 (1998) (“[W]hen lawmakers anoint a contract term the default, the substantive preferences of parties shift—that term becomes more desirable . . .”).

165. The need to reform contract doctrine to better reflect contract realities rather than the traditional rational actor assumptions is a central task of contemporary sociolegal scholarship.

166. *See* MITU GULATI & ROBERT E. SCOTT, *THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN* 164 (2013) (noting anecdotally that “litigators and transactional lawyers rarely combine their specialized skills at the level of the individual transaction”).

167. CATHERINE MITCHELL, *CONTRACT LAW AND CONTRACT PRACTICE: BRIDGING THE GAP BETWEEN LEGAL REASONING AND COMMERCIAL EXPECTATION* 32 (2013).

168. *See* M. H. Sam Jacobson, *A Checklist for Drafting Good Contracts*, 5 J. ASS’N LEGAL WRITING DIRECTORS 79, 80 (2008) (“Like any legal writing, good drafting requires knowing the law and the substance first . . .”).

169. Choi et al., *supra* note 110, at 3; *see also* Triantis, *supra* note 145, at 192 (identifying triggers for innovation in contract language to be “(1) learning, (2) regulatory changes and (3) changes in market conditions”).

this is undoubtedly true in some circumstances and in particular industries. Reputation and the potential for repeat dealings can constrain party behavior. Perhaps that is why we *do* see some use of these more flexible contracting methods despite inhospitable doctrine. But these nonlegal mechanisms only work in certain conditions.¹⁷⁰ Plenty of contracts are still litigated that appear not to have been self-enforcing.¹⁷¹ Further, studies have indicated that the prospect of future legal enforcement can be important to spur contracting, particularly when dealing with new partners.¹⁷² Finally, the development of braiding, where parties weave together formal and informal contract mechanisms, further supports the assumption that parties do not simply ignore the prospect of future litigation, or at least that this question is context- and industry-specific.¹⁷³

B. Doctrine Should Be Tolerant of Incompleteness

Because the current default rule universally disincentivizes incomplete contracts, it should be changed for the universe of contracts where flexible contracting is actually efficient. Whether one agrees with this statement depends in part on what one thinks the normative goal of contract doctrine should be. There are innumerable arguments on this point, ranging from efficiency to autonomy and fairness to consent, and everything in between. Focusing only on commercial contracting between two parties where these flexible contracting mechanisms are most likely to add value, however, there is more consensus than in other areas of contract law. The normative goal of doctrine should be to support commercial activity and generate efficient outcomes.¹⁷⁴ Good contract law meets the needs and expectations of the commercial parties.¹⁷⁵

170. See generally Badawi, *supra* note 26, at 1 (noting that contracts are not as self-enforcing in industries where transactions are infrequent and uncertain, such as “construction, tailored software, and the market for mergers and acquisitions”); see also Scott, *supra* note 2, at 1644 (“Reputations work best in markets for homogeneous goods or in ethnically homogeneous communities . . .”).

171. Scott, *supra* note 2, at 1644 (“[M]ost of the recently litigated cases do not appear to be self-enforcing in the traditional sense.”).

172. *E.g.*, Johnson et al., *supra* note 131, at 260–61 (discussing a study of contracts in post-communist countries and finding that formal court enforcement encourages parties to try out new suppliers and generally supports relational contracting).

173. See generally Ronald J. Gilson et al., *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377 (2010) (providing a discussion of braiding).

174. See, *e.g.*, Schwartz & Scott, *supra* note 116, at 556 (“[O]ur principal normative claim [is] that contract law should facilitate the ability of firms to maximize welfare when making commercial contracts.”); MITCHELL, *supra* note 167, at 3 (“For [the neoformalist] branch of

If efficiency and furthering commerce is the goal, the problem is evident. Parties would be better off by entering into flexible contracts in the contexts described in Part II. It would prompt more commercial activity, more collaboration, more innovation, and in general would grow the size of the pie.¹⁷⁶ But “the specter of litigation has made people less willing to use informal agreements to order their affairs.”¹⁷⁷ Contract law is still based on the classic ideal of contracting and the assumption of rational, self-interested actors. It imposes on the parties a structure that hinders efficient transacting. The assumptions on which the law was based—that incomplete contracts always result from error and are undesirable—do not match today’s reality. Doctrine is not adhering to its normative goal.

Perhaps doctrinal change is not necessary and parties will start experimenting with these contracting forms without the need to change the law.¹⁷⁸ It is true that some experimentation is happening, at least in certain industries. However, it will be hard to change the current default of complete, contingent contracting, in part because of the sociolegal deterrents discussed in Part II.B. Some sort of a shock—like a change to legal doctrine—will be necessary to encourage experimentation with more flexible contracts.¹⁷⁹

contract scholarship, the design of contracts and contract law should reflect instrumental goals such as wealth maximisation.”).

175. This is admittedly an oversimplification. Catherine Mitchell’s excellent book explores in some detail the relationship between contract law and commercial expectations. MITCHELL, *supra* note 167. She points out that it cannot be the case that we should just align contract law with whatever the parties would want. *Id.* at 4 (“Whatever the precise role of contract law in commercial dealing, it must involve more than simply arbitrarily bestowing legal validity on whatever actions or decisions the community of commercial contractors take in the pursuit of their business interests.”).
176. Although flexible contracting is in use in certain limited contexts, there is evidence that it should be used more widely. For instance, scholars suggest use of flexible contracting in government outsourcing and construction contracts, to name a couple. *See, e.g.*, Epstein, *supra* note 94 (manuscript at 7) (“[W]here the traditional method doesn’t work, governments should try the opposite and write less-detailed contracts.”); M. Motiar Rahman et al., *Building a Relational Contracting Culture and Integrated Teams*, 34 CAN. J. CIV. ENG. 75, 86 (2007) (finding that “trust and trust-based operational and contractual arrangements can effectively provide the right incentives for the . . . construction industry”).
177. Gergen, *supra* note 160, at 1401.
178. *Cf.* Ronald J. Gilson et al., *Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Forms*, 88 N.Y.U. L. REV. 170, 172 (2013) (arguing that contractual innovation starts with the parties and reaches the courts later in the process).
179. Choi et al., *supra* note 110, at 3.

The final Part suggests how doctrine should be reformed to better reflect and support these new models of contracting.

IV. CONTRACT DOCTRINE SHOULD BE BOTH CONTEXTUAL AND DYNAMIC

Having argued that the law should incentivize flexible contracting, this Part takes up the question of how that could be accomplished. Generally speaking, formalism begets complete, contingent contracts. Contextualism supports flexible contracting. This argument is not novel. But this Article goes a step further, suggesting that even contextualism as currently applied has the wrong focus to support flexible contracting. Contextualism is static, focusing on discerning the intent of the parties at contract execution.¹⁸⁰ But contracts are not static, particularly not the type that are the focus of this Article. They are dynamic and, at least for certain categories of contracts, contract interpretation should be, too.

A. Formalist Interpretation

There are many contexts where it makes sense to draft complete, contingent contracts: where transactions costs for doing so would be low, there is little uncertainty in the transaction, and market forces are well functioning.¹⁸¹ In these contracts, the main goal tends to be compliance, not collaboration or innovation. Parties drafting these sorts of complete contracts understandably prefer formalist interpretation.¹⁸² They have detailed the terms of their agreement and would prefer that a court just enforce it as drafted, relying on the four corners of the written document. Formalism in these circumstances has the benefit of certainty for the parties, makes litigation less costly, and supports the norm of freedom of contract. Parties preferring detailed drafting and formalist interpretation should be able to obtain it. This Article does not argue otherwise. Indeed, these parties can even specify this preference for formal interpretation explicitly in their complete contract. What this Article does argue, however, is that the default rule should not be formalist interpretation.

Despite the overall contextualist approach of the U.C.C. and the Restatement Second, “a strong majority of U.S. courts continue to follow the traditional, ‘formalist’ approach to contract interpretation

180. *But see supra* note 114 and accompanying text (discussing the law’s provision for course of performance evidence).

181. *See, e.g.,* Badawi, *supra* note 26, at 20 (suggesting that where industry transactions are “high frequency, low uncertainty, and take place in the context of high insularity,” parties can draft more complete contracts at lower cost and prefer formalist interpretation).

182. *Id.*

...¹⁸³ This is true for sophisticated parties in particular.¹⁸⁴ Courts frequently note that there is no need to “rewrite” an agreement entered into between sophisticated parties.¹⁸⁵ Particularly when it comes to questions of contract interpretation, then, courts are often more formalist when dealing with sophisticated parties.¹⁸⁶

The neoformalist movement suggests an even further move to the formalism pole. For instance, neoformalists have suggested a universal strengthening of the indefiniteness doctrine.¹⁸⁷ They argue that withholding enforceability of incomplete contracts will force parties to fully negotiate and specify contract terms that can later be easily interpreted by a court.¹⁸⁸ Parties who leave gaps in their contracts should not be able to shift the cost of *ex ante* drafting onto the judiciary *ex post*.¹⁸⁹ The canon of *contra proferentem* has a similar justification. Neoformalists also favor a strong parol evidence rule for much the same reason. Interpretive focus should be on the document, not on extrinsic evidence.

But because the default rule should not favor *ex ante* specification,¹⁹⁰ this Article takes issue with the formalist approach. To the contrary, the indefiniteness doctrine should be flexible, not strict; *contra proferentem* should be dispensed with; and courts

183. Schwartz & Scott, *supra* note 119, at 926.

184. Miller, *supra* note 113, at 495–96.

185. *Id.* at 496.

186. *Id.*; see also Schwartz & Scott, *supra* note 119, at 932 (“[B]oth the available evidence and prevailing judicial practices support the claim that sophisticated parties prefer textualist interpretation.”).

187. See Scott, *supra* note 111, at 859–60 (proposing that courts decline to interpret indefinite terms at all); George S. Geis, *Broadcast Contracting*, 106 NW. U. L. REV. 1153, 1193–94 (2012) (calling the indefiniteness doctrine “an important and legitimate escape valve for the interpretative task” because parties leaving gaps in contracts should not be able to externalize those costs).

188. See Scott, *supra* note 2, at 1647, 1687 (arguing that “the theory of reciprocal fairness supports adherence to the common law indefiniteness doctrine,” which is that a contract is unenforceable unless it is “certain and definite such that [the parties’] intention may be ascertained with a reasonable degree of certainty”).

189. Geis, *supra* note 187, at 1194.

190. Parties could still choose *ex ante* specification. See Katz, *supra* note 162, at 521 (citing Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 570–71 (1998)).

should apply a (dynamic) contextual approach to interpretation.¹⁹¹ The next Section makes the argument.

B. Dynamic Contextualist Interpretation

A contextual approach is superior to a formalist approach when it comes to incomplete contracts.¹⁹² For formalism to work, the parties have to have put all of the important elements of their deal into the written document. Formalists argue that textualism is desirable because “[t]he greater the courts’ allegiance to the writing, the more careful will the parties be in drafting the written document.”¹⁹³ To incentivize *incomplete* contracts, that argument can simply be flipped on its head.

Contextualism allows the parties to purposely leave gaps in their contracts or use standard-like rather than rule-like language. Ideally, purposely incomplete drafting will lead to less litigation *ex post*. Flexible contracting can foster trust and collaboration, ultimately creating a more successful contracting relationship. If litigation does result, however, contextualism directs courts to discern the intent of the parties by looking to relevant evidence outside the four corners of the document. The hallmarks of contextualism are a weak indefiniteness doctrine and a weak parol evidence rule. A weak indefiniteness doctrine means that courts are willing to interpret or fill gaps in incomplete contracts rather than simply finding them unenforceable. A weak parol evidence rule means that courts are willing to consider a broader universe of evidence than simply what is in the four corners of the contract document.

Contextualism facilitates flexible contracting because it allows parties to purposely leave gaps and know that, if necessary, a court will still enforce the contract. Leaving a gap in a contextualist regime “may provide a stronger assurance that parties will adhere to industry norms and will generally comport themselves in a good faith manner, lest evidence to the contrary be admitted in a dispute.”¹⁹⁴ In general, the more evidence the court reviews, the more likely it is that the court will reach an accurate result.

191. Ben-Shahar, *supra* note 159, at 793 (“The greater the courts’ allegiance to the writing, the more careful will the parties be in drafting the written document.”).

192. MITCHELL, *supra* note 167, at 238 (“[T]he broad hallmark of a commercial-expectations approach to contract legal reasoning is a form of contextualism . . .”).

193. Ben-Shahar, *supra* note 159, at 793–94; *Id.* (“The form of the bargain is not exogenous: rather, it is tailored in light of the weight that the courts will likely assign to it. The content of the text is endogenously determined by the courts’ willingness to peek beyond the text.”).

194. Badawi, *supra* note 26, at 34.

But even the typical contextualist approach is still problematic. Contextualist courts use a weak parol evidence rule to evaluate extrinsic evidence for the purpose of discerning the intent of the parties at the time of contract formation.¹⁹⁵ According to the traditional view of contracts, the “deal” is that which is made when the parties sign on the dotted line. Courts interpreting contracts therefore ask about the intent of the parties at that discrete point in time.

The problem, however, is that the nature of the agreement between the parties is living, particularly with incomplete contracting. It evolves with time. Consider the example of contracting for innovation. Apple and SCI entered into an incomplete contract in part because the product had not yet been designed. The parties could not have specified details *ex ante*. So a contract interpretation process that relies on discerning intent of the parties *ex ante* simply does not make sense.¹⁹⁶ It sends a message to contracting parties that there is a premium on documenting the agreement at execution, whether it be in the contract document or in extrinsic evidence. In other words, while contextualism may not incentivize detailed drafting, it still incentivizes detailed *ex ante* agreement. Parties may just shift some of the cost from drafting the contract to documenting the agreement in other sources such as e-mail correspondence. Even with contextualist interpretation, the court is not asking the right question. This creates a high risk of error in court adjudication.

William Eskridge Jr. addressed a related issue in his influential work *Dynamic Statutory Interpretation*.¹⁹⁷ There he noted that *statutory* interpretation is static. Courts look to the language of a statute and legislative history to try to discern the intent of the legislature. The “intentionalist” approach asks how the legislature intended for the statute to be interpreted at the time it passed the law. This approach, according to Eskridge, is at odds with constitutional interpretation, which requires not just considering “the

195. See Yuval Feldman & Doron Teichman, *Are All Contractual Obligations Created Equal?*, 100 GEO. L.J. 5, 33 (2011) (“The main object of contract interpretation is to identify the intent of the drafting parties. As Lawrence Solan recently noted, the single concern of courts in interpretation cases ‘is to discover the intent of the parties, and reach a decision that will vindicate that intent.’”) (quoting Lawrence M. Solan, *Contract as Agreement*, 83 NOTRE DAME L. REV. 353, 388 (2007)).

196. See William C. Whitford, *Relational Contracts and the New Formalism*, 2004 WIS. L. REV. 631, 634 (2004) (“[A]n agreement occurs in stages and performance commonly begins before the final stages of the agreement process, creating various problems not well accommodated by traditional contract doctrine.”).

197. William N. Eskridge Jr., *Dynamic Statutory Interpretation*, 135 U. PA. L. REV. 1479 (1987).

constitutional text and its historical background, but also its subsequent interpretational history, related constitutional developments, and current societal facts.¹⁹⁸ Eskridge suggests that statutory interpretation should be more like constitutional interpretation. He argues that statutory interpretation should be dynamic, not static. Courts should interpret statutes “in light of their present societal, political, and legal context.”¹⁹⁹

Eskridge’s reasoning is highly salient to the contract context. Like statutory interpretation, contract interpretation is focused for the most part at the time of contract execution.²⁰⁰ It is static. This is problematic for the type of contracting envisioned in this Article, where efforts are collaborative and innovative and the parties cannot entirely specify their deals *ex ante*. For these deals, contract interpretation, like constitutional interpretation (and according to Eskridge, statutory interpretation), should be dynamic.

Melvin Eisenberg has started to outline the parameters of this argument.²⁰¹ He suggests that there is a spectrum from static to dynamic in contract doctrine. A contract doctrine lies at the static pole if its application turns entirely on what occurred at the moment in time when a contract was formed. A contract law doctrine lies at the dynamic pole if its application turns in significant part on a moving stream of events that precedes, follows, or constitutes the formation of a contract.²⁰²

For purposefully incomplete contracts, the stream of events that follows formation will often be relevant to interpretation questions. In terms of incentives, dynamic contract interpretation doctrine would encourage parties to use flexible contracting techniques. It mitigates the risk that an incomplete contract will not be enforced and increases the likelihood that a court will come to an accurate conclusion. In addition, a dynamic approach encourages parties to act fairly toward each other during contract performance.²⁰³ Ultimately, although it is

198. *Id.* at 1479.

199. *Id.*

200. *See id.* at 1479–80 (discussing the “originalist” approach to statutory interpretation).

201. *See* Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CAL. L. REV. 1743, 1748–49 (2000).

202. *Id.* at 1770 (“Contract interpretation must not only look at events before contract formation; it must also look at events after that time. Because contracts always evolve, or at least may always evolve, interpretation should take account of the way in which the parties live and grow their contracts.”).

203. Eisenberg argues that contract law is moving in the direction of dynamic interpretation because the U.C.C. and Restatement allow courts to consider course of performance in interpretation issues. *See id.* (citing U.C.C. § 2-208(1)). However, course of performance usually

contract doctrine that would only be applied if litigation resulted, such an approach would also make litigation less likely.

In sum, current contract law is too formalist, at least for this segment of contracts for which incomplete drafting is preferential. Formalist interpretation imposes costs on parties, forcing them to draft complete contracts. These costs are especially high for the types of contracts discussed in Part I.C. But the current method of contextualist interpretation is not far superior to formalism because like formalism, it forces the parties to come to *ex ante* agreement, whether or not they detail it in the contract. The better solution would be a dynamic, contextualist approach for the types of contracts that are the focus of this Article. This approach would increase the likelihood that courts will get the result right in litigation but, even more importantly, removes the doctrinal obstacle to purposefully incomplete contracting.

C. Limitations

There remain, however, a number of arguments against a dynamic, contextual approach to consider. First, critics will argue that such a system would mean high-cost litigation. Formalist interpretation allows courts to consider the most limited evidentiary base, making litigation under a formalist regime the least costly. Contextualist interpretation is more costly than formalist interpretation because it requires review of a larger evidentiary base. Dynamic contextualism might be the most costly of all because it requires the largest evidentiary base given the expanded temporal reach of the interpretation question.

It is true that dynamic contextualism might be the most costly, but it is also likely to be the most accurate.²⁰⁴ In addition, the

comes up in a very specific and limited context. For instance, one company contracts to make five separate shipments of widgets and no place of delivery is specified. If the first three deliveries are made to buyer's place of business (default rule would specify delivery at seller's), delivery to buyer becomes a contract term through course of performance. In practice, however, courts rarely consider post-formation activities in contract interpretation matters. *See, e.g.*, CORBIN ON CONTRACTS: INTERPRETATION OF CONTRACTS § 24.3 (Joseph M. Perillo ed., rev. ed. 1998) ("Through 'interpretation' of a contract, a court determines what meanings the parties, *when contracting*, gave to the language used.") (emphasis added).

204. Neoformalists Schwartz and Scott acknowledge the tradeoff between litigation cost and accuracy but argue that "[t]his tradeoff implies that risk neutral business parties will commonly prefer judicial interpretations to be made on a limited evidentiary base, the most important element of which is the contract itself." Schwartz & Scott, *supra* note 119, at 926; *see also* Larry A. DiMatteo & Daniel T. Ostas, *Comparative Efficiency in International Sales Law*, 26 AM. U. INT'L L. REV. 371, 403 (2011) ("[E]xtrinsic evidence that offers insight into the

prospect of costly litigation has a side benefit—it should bond parties not to seek litigation where issues can be resolved by other means.²⁰⁵

A second concern is that a dynamic contextualist approach is at odds with the ideal of certainty. It is undoubtedly true that more highly specified contracts combined with formalist interpretation provide more certainty for the parties. But the type of contract most in need of flexible drafting methods is one in which there is inherent future uncertainty. In some sense, this problem is unavoidable.

Third, if it is true that sophisticated parties prefer textualism, why have a law that is at odds with commercial preferences? But as stated earlier, parties preferring formalist interpretation can still specify as such in their agreements. The suggestion, here, is merely to change the default rule for a particular class of contracts.

Finally, some may argue that changes in contract drafting must come from parties and not from changes in doctrine. And we have seen some party experimentation with flexible contracting. However, the combination of sociolegal and doctrinal deterrents makes an optimal level of experimentation unlikely to occur absent some change.

CONCLUSION

If the normative goal of contract law is to “facilitate the ability of firms to maximize welfare when making commercial contracts,”²⁰⁶ current doctrine is out of step with this objective. Current doctrine assumes a model of contracting that is no longer commensurate with commercial realities. It assumes that incomplete or vague contracts result from laziness or errors and are always undesirable. Doctrine, therefore, is designed to encourage parties to specify their contracts. Detailed contracts are supposed to deter opportunism and make litigation less likely.

But recent scholarship paints a much different picture. It demonstrates that in certain contexts, incomplete contracts are desirable. Less-specified contracts foster trust and collaboration and minimize cognitive problems that arise when parties strictly adhere to detailed requirements rather than focus on the larger purpose of the agreement. But there are both doctrinal and sociolegal deterrents to parties drafting purposely less-specified contracts, even when doing so would otherwise be efficient.

parties’ true intentions provides the most efficient interpretation of contractual terms.”).

205. See Choi & Triantis, *supra* note 1, at 856 (listing alternatives to traditional litigation).

206. Schwartz & Scott, *supra* note 116, at 556.

Formalist contract interpretation is designed to force parties to specify their deals *ex ante*. Contextualist interpretation is somewhat better, but the focus is still largely on the intent of the parties at contract execution. This is problematic for flexible contracting, where the goal is to have the parties' deal evolve over time. This Article therefore suggests a more nuanced and dynamic approach to contract interpretation for a particular class of contracts, one that increases the likelihood that courts will reach an accurate conclusion but that also gives parties the right incentives to engage in flexible contracting.