ABSTRACT

Lawyers are the engineers and architects of contractual frameworks. Arguably, with respect to the success of the undertaking, they occupy a place of equal importance to the parties executing the contracts. After all, contracts are put in place to help prevent problems from arising in long-term business relations. As studies of business interactions show time and again, and I have discussed in earlier articles, keeping conflict at bay in long-term business relations is not an easy task. Many are still perplexed to learn what the research consistently indicates: that contracts themselves are partly responsible for the tensions that arise. In fact, contracts seem to do little to preserve relationships; instead, they tend to fuel disputes and trigger costly litigation.

What are the factors that underlie this common failure of contracts? It appears that contract drafters ignore non-contractual norms when designing contracts, which leads to tension during the contractual relationship. In earlier work I identified a number of non-contractual factors that influence parties actions but rarely find a place in contracts (Kamminga 2008; 2011). These non-contractual drivers influence contract parties' behavior and can, in fact, encourage parties to act contrary to what the contract text directs them to do. This article takes a problem solving approach: it studies the dynamic between various drivers of contractual behavior more in-depth, and looks into the drivers triggering or impeding evolution in contract design. I discuss why and how lawyers may better manage tensions and prevent disputes by revising their contract design methods and choices (and how to convince them to do so).

What follows is a discussion of the dynamic interplay between the formal and informal governance mechanisms at work in every long-term relationship. In addressing this matter, this paper points out (a) why lawyers experience very little incentive to search for ways to improve the cooperation function of contracts; (b) how to overcome these obstacles; and (c) how to integrate social and economic drivers to increase the effectiveness of contracts. To this end, a framework is put forward that might be used to (1) identify tensions between formal and informal gover-

nance structures in actual contracts and (2) provide a roadmap for contract design that foreshadows and possibly eliminates some of these tensions during the contract drafting process. This article aims to contribute to a broader discussion of more effective ways in which transaction lawyers can contribute to society and, more specifically, the paper explores how a more holistic approach to contract design may help prevent conflict and achieve better results for contract parties.

INTRODUCTION

Our contractual relations are governed by a variety of norms and rules. The laws to which we are subject, the economic interests we hold, the social rules that govern our society, the nuances unique to each interaction, and elements that we invent as we go along all comprise these norms and rules. Together, they determine how we interact and cooperate. At the core of the network of formal and informal governance mechanisms are the arrangements between the main parties laid down in contracts. This core is what lawyers and many parties tend to focus on, almost exclusively, when negotiating and enforcing contracts.

The flaw that so often undermines contracts is that they do not seem up to the task of dealing with the complexities of today's long term contractual relationships. Frequently, contract documents are unable to help parties get the process related to their collaboration back on track. Not only do written agreements routinely fail to keep parties on course when they have a disagreement, contracts themselves are often suspected and identified as the cause of problems. It appears that their active use as governance instruments may increase the chances of a breakdown of cooperation. There is ample evidence to confirm that instead of functioning as guideposts for the contract parties, the ideal represented in contract literature, contracts, in practice, often disrupt the collaboration process and undermine the contractual relationship.

Empirical research reinforces this negative view of contracts. Studies show that parties are not fond of contracts as tools for keeping their cooperation on track (Passera *et al.* 2013). Some studies even suggest that complex contracts are alienating those that could make them a success (Malhotra 2012). When contract managers are asked about their experience with construction contracts, they often identify them as inadequate and as the starting point for disagreements. What they are missing is clear guidance for dealing with the consequences of, for instance, unexpected events or changes (Stephenson 1996: 11; Kamminga 2008). Whenever unexpected circumstances arise, initially, parties tend to dig in; they either hide behind the contract or point at lacu-

nae in the agreement. A supplier may use the contract as justification for change orders as they are asked to act in ways not specified in the contract. The purchaser, at the same time, may try to use that same contract to enforce penalties triggered by delays to the schedules as a result of discussion about whether change orders are justified. In this particular context, vague or punitive contract language can create an adversarial dynamic; it often fuels disputes that can lead to costly and uncertain litigation (Triantis 2013).

For those parties that try to maintain a collaborative atmosphere, the contract is of little use, and such parties rely on alternatives. Mostly, other informal mechanisms are used such as reputation or reciprocity. They are the main drivers in parties' dealings with each other (Macaulay 1963; Malhotra, 2012). However, these mechanisms only suffice as long as parties are able to resolve issues using the applicable non-contractual norms. As soon as differences of opinion arise that compel parties to take legal positions, non-contractual mechanisms fail and all that parties are left with is the contract. This slide toward conflict creates an uncomfortable situation because what is essential for the success of any long-term contractual relation – how parties will collaboratively achieve their goals – is not given a solid structure in contracting and contracts.

An interesting paradox has become evident. Our goal with contracts – at least in most Western countries – is to ensure that the other party will actually do what was initially promised, yet seem disinclined to carefully study what drives these parties apart and disrupts their contractual arrangements.[1] As a result of this gap in our inquiry, contract parties continue to be exposed to myriad, disruptive forces that contracts fail to address. These unexamined forces often have the capacity to undermine the chance of parties actually having a successful contractual relationship.

The remainder of this article discusses key factors that determine parties' contractual behavior. The objective is to further clarify how ignoring these forces at play in contracts may be harmful. The article will then analyze what possible avenues can be explored to design contracts that better cater to parties that want contracts to serve as guideposts for the cooperation process.

1. There are of course other economic mechanisms at work in a sector that make parties life up to promises that are not specified in the contract, such as reputation mechanisms or a strong sense of obedience to social norms, but these not always apply or have the expected result, see Bernstein 2001, and Elickson 1991.