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# CONTRACT REVIEW: COGNITIVE BIAS, MORAL HAZARD, AND SITUATIONAL PRESSURE

ERIC A. ZACKS\*

*This Article explores the contract drafting and review process of attorneys from a cognitive and social science perspective. Based on an understanding of the behavioral tendencies of individual attorneys as impacted by cognitive bias, moral hazard, and situational pressure, the drafting attorney may be able to secure particular transactional advantages for her client. For example, the anchoring effect, which suggests that individuals are affected by the presence by an initial value position, may explain why drafters should and do include extreme positions in their initial draft. Similarly, time pressure may affect an attorney's review of a contract, which a drafting attorney can anticipate and exploit to her advantage by increasing contract length and complexity. The drafting attorney can also seek to take advantage of particular moral hazards that the reviewing attorney faces when representing clients, such as when the reviewing attorney is compensated on a per-transaction basis or would like to appease the client and avoid disrupting a transaction. Understanding the cognitive processes and situational influences helps explain or predict particular patterns of contracting behavior. These factors suggest significant limitations in the attorney as an effective tool in checking opportunistic behavior, both prior to and after contract formation, and undermine a positive model of the transactional attorney as a value-adding transaction cost engineer.*

“Lawyers function as transaction cost engineers, devising efficient mechanisms which bridge the gap between capital asset pricing theory’s hypothetical world of perfect markets and the less-than-perfect reality of effecting transactions in this world.”

—Ronald J. Gilson<sup>1</sup>

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<sup>1</sup> Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 255 (1984).

“It’s too light. It feels like a ‘C.’ Bulk it up and add a few multicolored graphs.”

—Rodney Dangerfield<sup>2</sup>

## I. INTRODUCTION

Drafting and reviewing a written contract is already understood to be a complicated and complex process. Not only are the attorneys charged with doing so expected to reflect accurately the agreed-upon promises of the two parties, but they also are expected to address possible (and sometimes unforeseeable) contingencies, ensure legal enforceability of the document, protect the client from opportunistic behavior of the other party once the contract has been signed, and address dispute resolution issues, among a myriad of other issues. In this view, the attorneys preparing and reviewing the contract are charged with getting “the deal right” and making sure the contract is “legal.”<sup>3</sup> Attorneys also may add value as “transaction cost engineers” responsible for minimizing transaction costs or market inefficiencies that could disrupt the transaction.<sup>4</sup>

The traditional accounts, however, of the role of the contracts attorney ignore the human element involved with contract review and revision. The reviewing attorney is a human being, which means that the drafting attorney needs to understand how individuals make decisions and judgments. Different characteristics and situations may suggest different strategies for the attorney preparing the draft of a contract. Knowledge of human decision-making behavior and processes as well as the variation within transaction contexts could be invaluable to effective representation of one’s client, but more importantly, may help explain current contracting behavior. There also may be inherent constraints that prevent an attorney from utilizing any information or control advantages to her client’s advantage.

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<sup>2</sup> BACK TO SCHOOL (Paper Clip Productions 1986).

<sup>3</sup> George W. Dent, Jr., *Business Lawyers as Enterprise Architects*, 64 BUS. L. 279, 286 (2009) [hereinafter Dent, *Business Lawyers*] (“Gilson highlights the role of lawyers in producing and verifying information. . . . [C]lients rationally pay lawyers (and other agents, like accountants) big fees for this service.”); Gilson, *supra* note 1, at 242 (“When my question—what does a business lawyer *really* do—is put to business lawyers, the familiar response is that they ‘protect’ their clients, that they get their clients the ‘best’ deal.”); Jason M. Klein, *No Fool for A Client: The Finance and Incentives Behind Stock-Based Compensation for Corporate Attorneys*, 1999 COLUM. BUS. L. REV. 329, 348 (1999) [hereinafter J.M. Klein] (“While the cynic may say that the lawyer has crafted the law so as to provide guaranteed employment for lawyers, the more astute observer may comment that the law has crafted lawyers so as to provide guarantees for clients.”).

<sup>4</sup> Gilson, *supra* note 1.

The drafting party might be able to gain advantages in the initial draft if the decision-making process of individuals is understood. Based on the predictable and systematic cognitive biases and judgment heuristics of the opposing attorney, the drafting party also may be able to draft in her client's favor. For example, understanding the anchoring effect, which suggests that individuals are affected by the presence by an initial position, as well as the status quo bias, may be instructive to drafting attorneys as they prepare the initial position of the parties in the contract.

In addition, drafting and reviewing the contract also should be understood as occurring within the larger context of a negotiation. As such, the initial draft of the contract is an important starting point for the negotiations that may occur following the opposing party's receipt of the draft. The drafting attorney, therefore, needs to be conscious of the negotiation process that likely will follow based on the transaction context. For example, if the attorney is preparing a contract that will be sent to an opposing party without an experienced attorney or to an opposing party with less bargaining power, then the drafting attorney might expect the negotiation process to be short or non-existent. Accordingly, the drafting attorney may prepare a more one-sided contract with the expectation of little resistance.

Moreover, the drafting party needs to be cognizant of the situational pressures that can influence each individual involved in the contract review process. For example, if there is time pressure to execute the contract (to get the deal done) on one or more of the clients involved in the transaction, then the drafting attorney should prepare a draft that reflects the time advantage or disadvantage of her client. If time is on her client's side, then it may be possible to prepare a more one-sided contract, as the opposing party may put pressure on its attorney to accept all but the most important terms as drafted. Similarly, the reviewing attorney also may face a moral hazard when she reviews the initial draft. If the reviewing attorney is more concerned with pleasing the client and not appearing to be an obstructionist to the transaction, or if the reviewing attorney is being compensated on a per-transaction as opposed to an hourly basis, there may be reasons that the reviewing attorney will scrutinize the contract less thoroughly. There are innumerable variations of the different negotiating context and situational pressures, and a drafting attorney should be cognizant of how these variations should be factored into the initial draft of the contract.

Scholarship concerning contract design, however, has not addressed the impact or situation of the initial draft of the written contract upon the opposing attorney. Some have focused on the ability of contracts

to influence the non-drafting contract party when executing a contract.<sup>5</sup> Similarly, I have argued that contracts may be prepared to exploit the cognitive biases and decision-making processes of adjudicators.<sup>6</sup> This Article instead focuses on contract preparation in contemplation that an attorney will be on the other side reviewing one's draft. I argue that there are many situational and cognitive factors to be considered when drafting a contract for review by the opposing counsel and that the potential impact of such factors should not be ignored or understated. Without understanding the decision-making process of the individual attorneys that review a contract draft, one is left with an incomplete understanding of contracts and contracting behavior.

The balance of this Article proceeds as follows: Section II describes three different traditional explanations of the role of the contract drafting and reviewing attorney. These explanations, however, do not completely account for the imperfect human elements involved in contract review. Section III describes how the reviewing attorney may be susceptible to different cognitive biases and judgment heuristics, which can be anticipated by the drafting attorney. Next, Section IV examines how, in a related manner, situational pressures and moral hazards may exist for the reviewing attorney. These pressures and moral hazards, as with systematic decision-making processes, may provide the drafting attorney with the opportunity to draft strategically or opportunistically. This Article then addresses various constraints on strategic or opportunistic drafting in Section V. Section VI concludes by examining the significant implications of strategic drafting for existing models of the transactional attorney.

## II. THE ROLE OF ATTORNEYS IN CONTRACT DRAFTING AND REVIEW

Before considering possible contract drafting scenarios, it is useful to consider the traditional views regarding the role of the attorneys involved in drafting and reviewing contracts. These views consider the relevance of transaction costs and economic agency, which help explain the use of attorneys in these situations as well as the underlying structure of the relationship between opposing parties' attorneys.

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<sup>5</sup> See, e.g., OREN BAR-GILL, *SEDUCTION BY CONTRACT: LAW, ECONOMICS, AND PSYCHOLOGY IN CONSUMER MARKETS* (2012); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203 (2003); Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165 (2003).

<sup>6</sup> Eric A. Zacks, *Contracting Blame*, 15 U. PA. J. BUS. L. 169, 171 (2012) [hereinafter E.A. Zacks, *Blame*].

### A. Engineering Transaction Costs

Contract preparation and review by attorneys can be understood as part of the attorney's role as manager of the transaction costs inherent in any exchange between two parties.<sup>7</sup> Gilson used the term "transaction cost engineers" to describe the role that business lawyers can play to add increase overall transaction value by reducing transactional inefficiencies.<sup>8</sup> These inefficiencies arise from the real-world exceptions to the theoretical assumptions of a perfect market, including the assumption the parties to a transaction have a common time horizon, the same expectations, have access to available information, and have no transaction costs.<sup>9</sup> In reality, of course, these are often barriers to closing the deal.<sup>10</sup> Value is created when lawyers allow for the parties to close the deal by lessening or fixing these market imperfections and allow the assumptions to be accurate.<sup>11</sup>

One way for lawyers to address these market imperfections is through contracts.<sup>12</sup> For example, when selling a business, the seller and buyer may have different opinions regarding the future prospects of the business and be unable to agree on a purchase price. A lawyer could add value (and permit a transaction to occur) by ameliorating this difference in opinion through an "earnout" contract or provision to condition payment on

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<sup>7</sup> Gilson, *supra* note 1 (suggesting "that the tie between legal skills and transaction value is the business lawyer's ability to create a transactional structure which reduces transaction costs and therefore results in more accurate asset pricing"); Barak Richman, *Contracts Meet Henry Ford*, 40 HOFSTRA L. REV. 77, 77 (2011) (noting that "we think of lawyers only as the proverbial 'transaction cost engineers,' the loyal agents of parties to the transaction"). Transaction costs include discovering "who it is that one wishes to deal with, to inform people that one wishes to deal and on what terms, to conduct negotiations leading up to a bargain, to draw up the contract, to undertake the inspection needed to make sure that the terms of the contract are being observed, and so on." R. H. Coase, *The Problem of Social Cost*, 3 J. L. & ECON. 1, 15 (1960).

<sup>8</sup> Gilson, *supra* note 1; J.M. Klein, *supra* note 3, at 350 ("[B]y serving as a transaction cost engineer, the lawyer reduces the overall costs of doing a deal and allows the deal to be valued with greater clarity.").

<sup>9</sup> Gilson, *supra* note 1, at 253.

<sup>10</sup> *Id.*; Lisa Bernstein, *The Silicon Valley Lawyer as Transaction Cost Engineer?*, 74 OR. L. REV. 239, 240 (1995) [hereinafter L. Bernstein] (suggesting that lawyers can play many different roles to assist the parties to overcome barriers to transactions, including by "counseling," "dealmaking," "matchmaking," "gatekeeping," "proselytizing," or "conciliating").

<sup>11</sup> Gilson, *supra* note 1, at 253–54; J.M. Klein, *supra* note 3, at 349 ("Lawyers add value to clients by recognizing this tension [arising from legal enforcement uncertainty] in the market for performance of promises and pricing it accordingly into the promise itself, resulting in a more efficient environment in which clients operate.").

<sup>12</sup> Gilson, *supra* note 1, at 298 ("Knowledge of alternative transactional forms and skill at translating the desired form into appropriate documents are as central to engineering transactions for the purpose of reducing transaction costs as for the purpose of reducing regulatory costs.").

future business performance.<sup>13</sup> In another context, the use by attorneys of “standard contractual forms may create value by reducing transaction and negotiating costs, reducing the likelihood of transaction breakdown, and, perhaps, increasing the amount of information about particular parties’ willingness to abide by community norms.”<sup>14</sup>

From the client’s view, however, attorneys may not add value but instead represent a cost to the overall transaction.<sup>15</sup> Regardless of whether one believes that attorneys add or lower overall transaction value, the contract attorneys’ role is understood to involve managing the document governing the exchange and the exchange’s process so the costs of accomplishing each side’s expectations, both before and after the transaction, do not threaten the existence or occurrence of the exchange.<sup>16</sup>

### B. Addressing Post-Formation Moral Hazard

One of the roles of the contract law attorney when preparing the written contract derives from one of the ultimate purposes of the written contract, namely, constraining opportunistic behavior of the opposing party after the contract has been executed.<sup>17</sup> The possibility of opportunistic behavior arises based on the economic agency relationship between each contractual promisor and promisee.<sup>18</sup> Once one party has been tasked

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<sup>13</sup> *Id.* at 262–63.

<sup>14</sup> L. Bernstein, *supra* note 10, at 250.

<sup>15</sup> Gilson, *supra* note 1, at 241–42 (noting that some view transactional lawyers “at best as a transaction cost, part of a system of wealth redistribution from clients to lawyers; legal fees represent a tax on business transactions to provide an income maintenance program for lawyers”).

<sup>16</sup> *Id.* at 255.

<sup>17</sup> INÉS MACHO-STADLER & J. DAVID PÉREZ-CASTRILLO, AN INTRODUCTION TO THE ECONOMICS OF INFORMATION: INCENTIVES AND CONTRACTS 3–4 (2d ed. 2001) (describing the “theory of *contracts under asymmetric information*, a theory that analyses the characteristics of optimal contracts and the variables that influence those characteristics, according to the behaviour [sic] and information of the parties to the contract”); BERNARD SALANIÉ, THE ECONOMICS OF CONTRACTS 2 (2d ed. 2005) (describing how the “theory of contracts [originates in] the failures of general equilibrium theory,” including informational asymmetry); Edward A. Bernstein, *Law & Economics and the Structure of Value Adding Contracts: A Contract Lawyer’s View of the Law & Economics Literature*, 74 OR. L. REV. 189, 194 (1995) [hereinafter E.A. Bernstein] (“The real value added to the transaction is the value of the transaction. . . implemented by a contractual promise, *less* both the costs incurred in placing the promise in legally enforceable form and the value of voluntary performance.”).

<sup>18</sup> Michael C. Jensen & William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (“We define an agency relationship as a contract under which one or more persons (the principal(s)) engage another person (the agent) to perform some service on their behalf which involves delegating some decision making authority to the agent.”); *id.* at 311 (“Contractual relations are the essence of the firm, not only with employees but with suppliers, customers, creditors, etc. The problem of agency

through the contract to perform a particular act, then from an economic standpoint, the promissor is now the economic agent of the promisee (the principal) empowered to perform an act for another (the promised-for performance) and is now the agent of the other with respect to that task.<sup>19</sup>

Because the parties' economic interests are different, the promissor (the economic agent) may face a moral hazard and be inclined and incentivized to act in a number of ways that are below the desired performance level.<sup>20</sup> Obviously, in many cases, the interests of the parties may be different: the promisee would generally prefer a higher quality and less remunerative performance, while the promissor would prefer a lower quality and more remunerative arrangement.<sup>21</sup>

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costs and monitoring exists for all of these contracts.”); Edgar Kiser, *Comparing Varieties of Agency Theory in Economics, Political Science, and Sociology: An Illustration from State Policy Implementation*, 17 SOC. THEORY 146, 146 (1999) (“Agency relations exist in a wide variety of social contexts involving the delegation of authority, including clients and various service providers.”).

<sup>19</sup> Trond Petersen, *Recent Developments in: The Economics of Organization: The Principal-Agent Relationship*, 36 ACTA SOCIOLOGICA 277, 277 (1993) (“A principal-agent relationship arises when a principal contracts with an agent to perform some tasks on behalf of the principal.”).

<sup>20</sup> Gregory S. Dawson, Richard T. Watson & Marie-Claude Boudreau, *Information Asymmetry in Information Systems Consulting: Toward a Theory of Relationship Constraints*, 27 J. MGMT. INFO. SYS. 143, 150 (2010) (“Agency theory posits that the agent (the person performing the work) might behave opportunistically if the agent's goals conflict with the principal's.”); Jensen & Meckling, *supra* note 18, at 308 (“If both parties to the relationship are utility maximizers there is good reason to believe that the agent will not always act in the best interests of the principal.”); Peter Wright, Ananda Mukherji & Mark J. Kroll, *A Reexamination of Agency Theory Assumptions: Extensions and Extrapolations*, 30 J. SOCIO-ECON. 413, 415 (2001) (“Opportunism is perceived as self-interest seeking with guile. . . . Thus, the expectation is that economic actors may disguise, mislead, distort, or cheat as they partner in an exchange.”)(citation omitted).

<sup>21</sup> ERIC A. CHIAPPINELLI, CASES AND MATERIALS ON BUSINESS ENTITIES 90 (2d ed. 2010) (“The principal wants the task performed at the lowest cost; the agent wants the highest remuneration with the least effort. . . . Measured strictly from the principal's economic best interest, principals have an incentive to ratchet because they get the desired task performed at a lower cost.”); Jörg G. Hülsmann, *The Political Economy of Moral Hazard*, 1 CZECH J. POLITICKÁ EKONOMIE 35, 37 (2006) (“[I]n the case of an agency contract, moral hazard can arise when an economic good is not effectively controlled by its owner (the ‘principal’) but by a different person called the ‘agent’. . . . The agent, who is fully informed about his own activities, has an incentive to act in his own material interest against the material interests of his less informed principal.”); Douglas E. Stevens & Alex Thevaranjan, *A Moral Solution to the Moral Hazard Problem*, 35 ACCT., ORGS. & SOC'Y 125, 125 (2010) (“After accepting the offer, however, the agent prefers to shirk and provide less than the agreed-upon level of effort because he is assumed to be effort-averse and morally insensitive (*i.e.*, opportunistically self-interested).”); Wright, Mukherji & Kroll, *supra* note 20 (“In spite of provision of incentives and monitoring, it is anticipated that opportunism may prevail because of adverse selection or moral hazard.”).



This difference in economic interests becomes more problematic in an agency relationship when there is a disparity between the parties' respective amount of information and control.<sup>22</sup> For example, a promisee may have less information as to the qualifications of the promisor to perform adequately in the first place.<sup>23</sup> The promisee may also be unable to detect whether the promisor is performing (or did perform) as the promisee would prefer.<sup>24</sup> Based on the superior information of the

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<sup>22</sup> Kathleen M. Eisenhardt, *Agency Theory: An Assessment and Review*, 14 ACAD. MGMT. REV. 57, 58 (1989) (describing the "agency problem that arises when (a) the desires or goals of the principal and agent conflict and (b) it is difficult or expensive for the principal to verify what the agent is actually doing"); Hülsmann, *supra* note 21, at 35 ("Moral hazard is present in 'actions of economic agents [...] to the detriment of others in situations where they do not bear the full consequences [...] of their actions.'")(citations omitted); *id.* ("Thus the essential feature of moral hazard is that it incites some people A to expropriate other people B."); *id.* at 37 ("Whenever the principal cannot effectively monitor the activities of his agent, therefore, the latter has an incentive to increase his own (monetary and psychic) income at the expense of the former."); Stevens & Thevaranjan, *supra* note 21 (The principal-agent "model raises expectations about the occurrence of self-interested behavior and the usefulness of financial incentives in solving the moral hazard problem"); C. Kirabo Jackson & Henry S. Schneider, *Do Social Connections Reduce Moral Hazard? Evidence From the New York City Taxi Industry*, (NBER Working Paper No. 16279, 2010), available at <http://www.nber.org/papers/w16279> ("When an economic agent does not bear the full cost or full fruit of her actions, a moral hazard may arise in which the agent, through doing what is personally optimal, behaves in ways that are sub-optimal from a social standpoint...")(citation omitted)

<sup>23</sup> Because of this disparity in information, agents may be able to misrepresent their qualifications to the principals. MACHO-STADLER & PÉREZ-CASTRILLO, *supra* note 17, at 11 (noting that in "adverse selection" problems, "the principal can verify the agent's behaviour, but the optimal decision, or the cost of this decision, depends on the agent's type, that is, on certain characteristics of the production process of which the agent is the only informed party. . . . [including] personal characteristics of the agent"); Ramon Casadesus-Masanell & Daniel F. Spulber, *Trust and Incentives in Agency*, 15 S. CAL. INTERDISC. L.J. 43, 70 (2005) ("The purpose of the [legal] agent is to exercise delegated authority, because the principal chooses to act through an intermediary. Because the agent is the one actually doing the job, he will generally have better knowledge of the circumstances surrounding the relationship."); Eisenhardt, *supra* note 22, at 61 ("*Adverse selection* refers to the misrepresentation of ability by the agent. . . . Adverse selection arises because the principal cannot completely verify [the agent's] skills or abilities either at the time of hiring or while the agent is working.").

<sup>24</sup> GLENN BLACKMON, INCENTIVE REGULATION AND THE REGULATION OF INCENTIVES 7 (1994) (describing the principal-agent problem in terms of the ability of the agent to "take some actions that further his interests at the expense of the principal's interests. It is difficult (i.e., expensive) to monitor or verify the behavior of the agent"); MACHO-STADLER & PÉREZ-CASTRILLO, *supra* note 17, at 9 (describing labor situations where, even though the agent's results are verifiable (such as number of units sold), the agent's specific effort and time dedicated to a task cannot be observed by the principal); Eisenhardt, *supra* note 22, at 58 ("The problem here is that the principal cannot verify that the agent has behaved appropriately."); Bengt Holmstrom, *Moral Hazard and Observability*, 10 BELL J. ECON. 74, 74 (1979) ("The source of this moral hazard of incentive problem is an

promissor as well as the nature of the contractual relationship in which a task is delegated to another, the promissor often will have more control than the promisee with respect to the quality, timing, and other parameters of the promissor's actual performance.<sup>25</sup>

Based on the differences in interests, information, and control between the parties, each promissor may be inclined and provided with the opportunity to act in her own interests to the detriment of the promisee.<sup>26</sup>

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asymmetry of information among individuals that results because individual actions cannot be observed and hence contracted upon.”). Peterson, *supra* note 19, at 278:

The principal-agent relationship is interesting when (a) there is some uncertainty in the way the agent's action gets transformed into the output, and (b) there is asymmetrical information, for example, the agent (e.g. a worker) observes her own action, but the principal (e.g. an employer) does not observe the action of the agent. The principal can then not be sure whether the agent acts in the principal's best interest.

<sup>25</sup> MACHO-STADLER & PÉREZ-CASTRILLO, *supra* note 17, at 10, states that problems can arise

[W]hen, before carrying out the effort for which he has been contracted, the agent observes the result of Nature's decision but the principal does not. . . . [B]efore the actual contracted action, the agent will have some sort of informational advantage by privately observing a relevant variable, for example, the level of effort that would be optimal. *Id.*

See also Kenneth J. Arrow, *The Economics of Moral Hazard: Further Comment*, 58 AM. ECON. REV. 537, 538 (1968):

The principal-agent relation is very pervasive in all economies and especially in modern ones; by definition the agent has been selected for his specialized knowledge and therefore the principal can never hope completely to check the agent's performance. You cannot therefore easily take out insurance against the failure of the agent to perform well. *Id.*

See also Casadesus-Masanell & Spulber, *supra* note 23, at 70–71:

The agent is often a specialist on the task he has been asked to perform, having a comparative advantage if not an absolute advantage relative to the principal, giving the agent greater capacity to process information and determine the most desirable course of action. The information asymmetry between principal and agent brings the agent to a position of power in the relationship that makes the principal dependent on the agent's judgments and actions. *Id.*

Kiser, *supra* note 18, at 146 (“[O]nce principals delegate authority to agents, they often have problems controlling them, because (1) agents' interests often differ from theirs, and (2) agents often have better information about their actions than do principals.”).

<sup>26</sup> Dawson, Watson & Boudreau, *supra* note 20 (“Agency theory posits that the agent (the person performing the work) might behave opportunistically if the agent's goals conflict with the principal's.”); Hülsmann, *supra* note 21 (“Whenever the principal cannot effectively monitor the activities of his agent, therefore, the latter has an incentive to increase his own (monetary and psychic) income at the expense of the former.”); Jenson & Meckling, *supra* note 18, at 308 (“If both parties to the relationship are utility maximizers there is good reason to believe that the agent will not always act in the best interests of the principal.”); Wright, Mukherji & Kroll, *supra* note 20, at 414 (“Agency theory is rooted in economic

For example, a promisor could “shirk” or attempt to maximize the compensation realizable from the transaction, and the promisee may not have sufficient information to detect or control such behavior.<sup>27</sup>

Based on an understanding of the moral hazard facing promissors, the drafting attorney may be concerned with the contract’s ability to enable detection of and constrain the opportunistic behavior by the other contract party (that will be making contractual promises to the drafting attorney’s client).<sup>28</sup> Contractual promises are by definition legally enforceable promises, so the drafting attorney will want to make sure that the promised tasks are appropriately specified, conditioned, and monitored, and that the failure to perform such tasks is sanctioned as desired.<sup>29</sup> Against the

utilitarianism. . . . [T]he agency problem becomes more evident—if both the agent and the principal are utility maximizers, because the presumption is that the agent will not act in the best interests of the principal. . . .”(citation omitted).

<sup>27</sup> BLACKMON, *supra* note 24, at 7–8 (“It is tempting and easy to judge the agent to be ‘bad’ in this situation. . . . Often the shorthand description of the agent’s behavior carries this negative connotation. The agent may ‘shirk,’ engage in ‘slack,’ or . . . engage in ‘abuse.’”); *id.* at 8 (noting that “the agent does not profit from his opportunity to shirk, slack, or abuse as long as the principal anticipates the agents [sic] opportunity to so behave”); SALANIÉ, *supra* note 17, at 118 (“We speak of *moral hazard* when the Agent takes a decision (‘action’) that affects his utility and that of the Principal; the Principal only observes the ‘outcome,’ an imperfect signal of the action taken; the action the Agent would choose spontaneously is not Pareto-optimal.”); *id.* (“Because the action is unobservable, the Principal cannot force the Agent to choose an action that is Pareto-optimal.”); Eisenhardt, *supra* note 22, at 61 (“*Moral hazard* refers to lack of effort on the part of the agent. The argument here is that the agent may simply not put for the agreed-upon effort. That is, the agent is shirking.”).

<sup>28</sup> See, e.g., Casadesus-Masanell & Spulber, *supra* note 23, at 89 (“Economic analysis of the agency model seeks to characterize the terms of an optimal agency contract. Because of moral hazard, the principal must rely on performance based rewards such as bonuses and commissions to induce the agent to work.”); Dent, *Business Lawyers*, *supra* note 3, at 287 (criticizing Gilson’s “neglect of opportunism (i.e., self-interested behavior), including agency costs,” which should be included as part of the transaction costs that lawyers seek to manage); Alex Gershkov & Motty Perry, *Dynamic Contracts with Moral Hazard and Adverse Selection*, 79 REV. ECON. STUD. 268, 268 (2012) (discussing the relationship between a money manager (an agent) and an investor (a principal), in particular that “The investor’s problem then is how to design an optimal compensation contract in light of the moral hazard and adverse selection problems that arise from the fact that the manager’s quality and effort as well as the complexity of the available investment opportunities are the manager’s private information.”).

<sup>29</sup> RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981) (“A contract is a promise or set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.”); Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 AM. BUS. L.J. 727, 759 (2010) (examining “how contracts can be used to insure performance and as part of a preventive legal strategy”); Eisenhardt, *supra* note 22, at 58 (“[T]he focus of [agency] theory is on determining the most efficient contract governing the principal-agent relationship given assumptions about people (e.g., self-interest, bounded rationality, risk aversion). . . .and information (e.g., information is a commodity which can be purchased).”); Edith R. Warkentine, *Beyond*

backdrop of legal enforcement of such provisions, a contract can help alleviate disparities in information and control.<sup>30</sup> The role of the attorney drafting or reviewing the contract, then, is to try to minimize such asymmetries and to sanction opportunistic behavior through appropriate provisions in the contract.<sup>31</sup>

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*Unconscionability: The Case for Using “Knowing Assent” as the Basis for Analyzing Unbargained-for Terms in Standard Form Contracts*, 31 SEATTLE UNIV. L. REV. 469, 475 (2008) (“A contract may be loosely defined as a voluntary agreement that the law will enforce.”); Stefan Wuyts & Inge Geyskens, *The Formation of Buyer-Supplier Relationships: Detailed Contract Drafting and Close Partner Selection*, 69 J. MKTG. 103, 103 (2005) (“Theoretically, some researchers argue that detailed contract drafting offers a way to protect against the partner’s opportunism through the threat of legal enforcement. . . . whereas others argue that detailed contracts are seldom used in practice because they are costly to draft and enforce. . . .”)(citations omitted).

<sup>30</sup> DiMatteo, *supra* note 29, at 770 (“Contracts offer numerous ways of insuring performance, such as the use of letters of credit to insure payment in documentary credit transactions. The entire area of secured transactions attempts to assure a lender that the borrower will perform.”); Hülsmann, *supra* note 21, at 39 (noting that “principals acting on a free market . . . are also free to design contracting relationships in ways that minimise [sic]: (a) the danger of moral hazard arising in the first place and (b) the danger of moral hazard, once there, affecting them negatively”); Wright, Mukherji & Kroll, *supra* note 20, at 425 (“In spite of contracting, monitoring, and bonding efforts, however, there will still remain ‘some divergence between the agent’s decisions and those decisions which would maximize the welfare of the principal’”)(citations omitted). See also Wuyts & Geyskens, *supra* note 29, at 106:

Thus, through clearly articulated clauses, contracts narrow the domain around which parties can be opportunistic. For example. . . . precise statement of how each party is to perform decreases the likelihood that the partner will hide important performance-related information, such as information about capacity constraints. On the other hand, failing to specify all elements of the exchange contractually increases incentives for short-term cheating.

<sup>31</sup> Holmstrom, *supra* note 24, at 74 (“A natural remedy to [the principal-agent] problem is to invest resources into monitoring of actions and use this information in the contract.”). A contract, however, is not a perfect or inexpensive instrument. SALANIÉ, *supra* note 17, at 109 (describing how a fixed wage contract, if given to an agent whose actions cannot be observed by the principal, may induce “the Agent to choose selfishly the action that is least costly for him, and this in general is not optimal”); Casadesus-Masanell & Spulber, *supra* note 23, at 56 (“It can be prohibitively costly to write complete contracts that specify the duties and liabilities of each participant in every possible contingency. Moreover, it is costly to monitor the agent’s activities and such monitoring conflicts with the purpose of the agent as a decision maker acting under delegated authority.”); DiMatteo, *supra* note 29, at 761 (“[T]he gaps and ambiguity of the [incomplete] contract allow for more opportunistic behavior in the performance of the contract than would a more formalized contract”); Mark Geistfeld, *Manufacturer Moral Hazard and the Tort-Contract Issue in Products Liability*, 15 INT’L REV. L. & ECON. 241, 241 (1995) (“It is well known that contracting may lead to inefficient outcomes if consumers are not perfectly informed of product risks, so the types of imperfect information that might justify tort regulation are central to the issue of whether tort or contract rules should allocate liability for product-caused injuries.”); Benjamin Klein, *Transaction Cost Determinants of “Unfair” Contractual Arrangements*, 70 AM.

### C. Addressing Pre-Formation Moral Hazard

Contract preparation and review by attorneys may also be utilized because of the problematic economic agency relationship that exists between opposing parties prior to execution of the contract. The drafting party may be understood to be the economic agent of the other party with respect to the task of preparing the contract, which means that the parties again face the principal-agent problem, albeit in the pre-formation context.<sup>32</sup> In this manifestation of the principal-agent problem, the drafting party may have superior information and control with respect to determining the contents of the contract.<sup>33</sup> The problem may be somewhat more acute in this instance because of the diametrically opposed interests of the respective parties to the contract. In particular, each promisor will desire the most flexibility in, and compensation for, such promisor's performance, while each promisee will desire the least flexibility in, and compensation for, the promisor's performance.<sup>34</sup> Control of the draft may thus result in a contract that is heavily slanted in the drafting party's favor,

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ECON. REV. 356, 356–58 (1980) [hereinafter B. Klein] (noting that, because contracts cannot address all contingencies, “wealth-maximizing transactors have the ability and often the incentive to renege on the transaction by holding up the other party ... The question then becomes how much the hold-up problem can be avoided by an explicit government-enforced contract”); Juliet P. Kostriksy, *Plain Meaning vs. Broad Interpretation: How the Risk of Opportunism Defeats a Unitary Default Rule for Interpretation*, 96 KY. L.J. 43, 47 (2007–2008) (noting that “[o]pportunism [between contracting parties] arises because parties lack foresight about the future, and because bargaining over possible future contingencies and adding language to contracts is expensive”); Kyle J. Mayer and Nicholas S. Argyres, *Learning to Contract: Evidence from the Personal Computer Industry*, 15 ORG. SCI. 394, 396 (2004) (“The capacity for contracts to adequately safeguard relationship-specific investments against opportunistic behavior by a contractual power is, however, limited. This is because foreseeing all the possible future contingencies under which a contractual hazard can emerge is very difficult. . . .”).

<sup>32</sup> Eric A. Zacks, *The Moral Hazard of Contract Drafting*, 42 FLA. ST. U. L. REV. (forthcoming 2015) (manuscript at 24) [hereinafter E.A. Zacks, *Moral Hazard*], available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=2399875](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2399875) (“If one party has been empowered to prepare the contract on behalf of the other party (that will affect the contractual/legal relationship between the parties), then an economic agency relationship with respect to contract preparation may exist.”). This is distinct from the economic agency relationship that may exist between the parties following execution of the party, as discussed in Section II.B., *supra*. In that instance, each promisor is the economic agent of the other with respect to such promisor's contractual promises and the separate economic agency relationship that will exist *after* the contract has been executed. *Id.* at 16.

<sup>33</sup> *Id.* at 4 (“In contract law, the drafting party (the economic agent) may prepare contracts utilizing the same information and control asymmetries in order to advantage itself relative to the non-drafting party (the principal).”).

<sup>34</sup> *Id.* at 29 (“Thus, the agent has an interest in a written contract that provides the most flexibility for the agent, less exposure to potential liability for the agent, less flexibility for the other party, and a greater exposure to potential liability for the other party.”).

again based on the differing interests, information, and control of the parties with respect to preparation of the contract draft.<sup>35</sup>

In this instance, an attorney may be employed to both exploit and avoid the moral hazard faced by the drafting party. First, an attorney may be retained by the party responsible for drafting the contract in order to prepare a heavily slanted contract in favor of such party.<sup>36</sup> The attorney may prepare a heavily slanted contract and also utilize formatting, presentation, or language techniques designed to reduce the ability of the non-drafting party to detect the unfavorable provisions.<sup>37</sup> Once legalese, length, and complexity have been added to the contract, the non-drafting party may be unable to detect self-interested behavior on the part of the drafting party (the economic agent) and the drafting party's attorney (the economic agent's agent).<sup>38</sup>

Second, the non-drafting party may incur costs to detect or prevent such self-interested behavior, which may include retaining outside advisors.<sup>39</sup> Thus, the non-drafting party could hire an attorney to review the initial draft of the contract. The attorney presumably would be in a better position to advise as to whether the initial draft is appropriate.<sup>40</sup> This could

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<sup>35</sup> *Id.* at 32 (“As an economic agent, the drafting party now faces a moral hazard [as all agents do]. The drafting party is incentivized to prepare the contract in such a way as to maximize her interests.”).

<sup>36</sup> *Id.* at 30:

Accordingly, if the drafting party is a repeat player (such as a corporate entity that routinely does business with similarly situated customers), the drafting party also would prefer to have a contract that has a standard set of terms which are well understood by the drafting party and provide consistent legal results, even if that involves the engagement and expense of professionals. *Id.*

<sup>37</sup> *Id.* at 33 (“Similarly, drafting parties can deter detection of their actions by increasing the transaction costs for the non-drafting party involved with reviewing and negotiating the agreement, including by using legalistic language, lengthy agreements, or delayed delivery of contractual terms.”).

<sup>38</sup> *Id.* at 34–35:

[M]any parties entering into a contract may be unaware of the legal implications of particular language (even if the terms are understandable). In certain instances, the contract party may also not have the time (or not be inclined to spend the time) to read a lengthy contract to determine and consider the legal implications of each provision.

*See also* Naomi Miyake & Donald A. Norman, *To Ask a Question, One Must Know Enough to Know What is Not Known*, 18 J. VERBAL LEARNING & VERBAL BEHAVIOR 357, 362 (1979) (“The most interesting result is that novices do not ask many questions on material that is too difficult.... People do not appear to be able to cope with material too far beyond their present knowledge.”).

<sup>39</sup> Rachlinski, *supra* note 5, at 1219 (“Often, even if people employ a suboptimal strategy and cannot adapt, they can recognize their own limitations and hire others to help them make decisions.”).

<sup>40</sup> *Id.* at 1216 (“As an alternative to organizational choice, people can delegate their decisions to others. Many professionals offer more than just knowledge—they offer a better decisionmaking perspective.”).

include advising as to whether the written contract accurately describes and conditions the promised transactions (the “business deal”). The attorney could also advise as to terms included in the written contract that were not negotiated by the parties ahead of time.

An attorney also can help the principal to address problematic drafting by the drafting party (the agent).<sup>41</sup> For example, the attorney may be able to secure better transaction or contract terms.<sup>42</sup> The attorney also could revise the contract in her client’s favor.<sup>43</sup> The use of an attorney also may serve to reduce problematic decision-making processes employed by the principal, such as those associated with particular cognitive biases.<sup>44</sup> Employing an attorney, particularly an experienced or well-known attorney, also might be expected to deter the drafting party (or the drafting party’s attorney) from acting opportunistically and drafting a one-sided contract in the first place.

Thus, the employment of attorneys by clients entering into a contract can be understood as an agency cost incurred with respect to the principal-agent relationship that exists with respect to the preparation of the written contract.<sup>45</sup> These costs are designed to address the information asymmetries that otherwise would exist between the two parties with respect to the contents of the contract.<sup>46</sup>

The view of employing attorneys preparing or reviewing contracts as an agency cost is not necessarily inconsistent with the transaction cost engineer explanation. Under each theory, the attorney is engaged to make it more likely that the transaction (executing the contract) occurs. Whether as a transaction cost engineer or monitor of self-interested behavior, attorneys tasked with contract review are typically faced with many of the same

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<sup>41</sup> E.A. Zacks, *Moral Hazard*, *supra* note 32 (manuscript at 51).

<sup>42</sup> Rachlinski, *supra* note 5, at 1216–17 (“Attorneys, situated somewhat outside of the decisionmaking environment, can see multiple frames and other perspectives more easily than clients.”).

<sup>43</sup> E.A. Zacks, *Moral Hazard*, *supra* note 32 (manuscript at 52).

<sup>44</sup> See discussion *infra* Section III.

<sup>45</sup> E.A. Zacks, *Moral Hazard*, *supra* note 32 (manuscript at 52) (“Where sophisticated principals have incurred (or are able to incur) agency costs and attempted (or are able to) monitor the preparation of the contract, the agents’ behavior in light of the moral hazard may be constrained.”).

<sup>46</sup> *Id.* at 52–53. (“[W]here these agency costs are not or cannot be incurred regularly, there perhaps is more concern that the agent will be able to utilize her superior information and control to prepare a one-sided contract.”). The ability to employ attorneys may suggest that the client is able to protect herself with respect to such information asymmetries or boundedly rational behavior. Accordingly, situations in which attorneys have been utilized often suggest that the principal parties are “sophisticated,” and courts consequently are reluctant to disregard the significance of assent given to contracts negotiated in such circumstances. *Id.* at 58 (“However imperfect, the use of the ‘sophistication’ label allows courts to determine whether the principal (the non-drafting party) should or could have been able to detect any opportunistic behavior by the agent (the drafting party).”).

issues and may entail similar or complementary tasks. Instead of two principals interacting (with or without attorneys) to establish the “business” terms, the reviewing attorney is entrusted to ensure that the document mirrors shared expectations regarding performance and possible contingencies.<sup>47</sup> For example, an attorney typically is interested in ensuring that the contract reflects the terms of the transaction as explained by the principals, addresses likely contingencies, and constrains opportunistic behavior by the other business party after the contract has been executed.<sup>48</sup>

In each instance, however, these tasks are to be performed by human beings subject to cognitive biases, situational pressures, and moral hazards. The next Section discusses how these factors affect the reviewing attorney and provide the drafting attorney with an opportunity to draft strategically to exploit such factors.

### III. COGNITION AND CONTRACT REVIEW

This Section focuses on contract preparation in contemplation that an attorney will be on the other side reviewing one’s draft. Accordingly, this Section examines some of the decision-making biases and processes of the attorney responding to an initial contract draft. The section also examines the implications of these issues for contract preparation by the drafting party.

#### A. Anchoring

Anchoring may be an important part of contract preparation. Anchoring is an effect that “occurs when people consider a particular value for an unknown quantity before estimating that quantity.”<sup>49</sup> In other words, people are affected by the presence of a value, random or not, when determining what the proper value is or should be and adjust their calculations accordingly.<sup>50</sup> If one is exposed to high numbers (even

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<sup>47</sup> JAMES C. FREUND, ANATOMY OF A MERGER: STRATEGIES AND TECHNIQUES FOR NEGOTIATING CORPORATE ACQUISITIONS 44 (1975) (“The great bulk of every acquisition agreement is designed to answer in advance certain questions that might otherwise be the subject of differing interpretations, disputes, and ultimately litigation.”). Accordingly, Freund argues that “[o]ne of the lawyer’s key roles in an acquisition is to translate into legally cognizable concepts the often fragmentary and oversimplified notions of the parties as to the terms of the deal between them, and then to articulate those concepts through meaningful contractual words and phrases.” *Id.* at 44–45.

<sup>48</sup> See discussion *supra* Section II.B.

<sup>49</sup> DANIEL KAHNEMAN, THINKING, FAST AND SLOW 119 (2011).

<sup>50</sup> *Id.* at 119–20 (finding this true even if stated value has nothing to do with initial value); Chris Guthrie & Jeffrey J. Rachlinski, *Insurers, Illusions of Judgment & Litigation*, 59 VAND. L. REV. 2026 (2006) (“People generally adjust away from the initial anchor, but their adjustment is often insufficient, giving the initial anchor greater influence on the final estimate than is appropriate.”); Marcel Kahan



unrelated to the question), then one's answer to a question will be higher than it would be in the absence of such exposure.<sup>51</sup> This has consequences in the commercial setting. For example, it has been demonstrated that setting the initial price in a buy-sell transaction is an advantage.<sup>52</sup>

Accordingly, the initial draft of the written contract, including the one-sidedness or content of its terms, may have an anchoring effect.<sup>53</sup> This effect goes beyond the baseline that is necessarily created because the initial draft exists. To be clear, the presentation (and existence) of the written contract is necessarily a baseline from which all deviations will be

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& Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 74 WASH. U. L.Q. 347, 362 (1996) (“Once initial reference points, or ‘anchors,’ are established, adjustments to these initial anchors tend to be too small. Anchoring thus biases final judgments in the direction of the anchor.”).

<sup>51</sup> KAHNEMAN, *supra* note 49 (“What happens is one of the most reliable and robust results of experimental psychology: the estimates stay close to the number that people considered—hence the image of an anchor.”); Guthrie & Rachlinski, *supra* note 50, at 2027 (“Regardless of the underlying explanation, anchoring is a powerful phenomenon.”).

<sup>52</sup> KAHNEMAN, *supra* note 49, at 120 (“[T]he same house will appear more valuable if its listing price is high than if it is low, even if you are determined to resist the influence of this number....”); Guthrie & Rachlinski, *supra* note 50, at 2027–2028 (describing effect of revealing jurisdictional limits on damages on mock jury awards); Gregory B. Northcraft & Margaret A. Neale, *Experts, Amateurs, and Real Estate: An Anchoring-and-Adjustment Perspective on Property Pricing Decisions*, 39 ORG. BEHAV. & HUMAN DECISION PROCESSES 84, 94 (1987) (finding anchoring to be powerful even “in an information-rich setting where subjects had ample opportunity for interaction with information sources”); Dan Orr & Chris Guthrie, *Anchoring, Information, Expertise, and Negotiation: New Insights from Meta-Analysis*, 21 OHIO ST. J. ON DISP. RESOL. 597, 609 (2006) (“[A]nchoring at the bargaining table may lead to much more inefficiency and inequity than anchoring in the courtroom.”).

<sup>53</sup> SCOTT PLOUS, *THE PSYCHOLOGY OF JUDGMENT AND DECISION-MAKING* 151 (1993) (“People adjust insufficiently from anchor values, regardless of whether the judgment concerns the chances of nuclear war, the value of a house, or any number of other topics.”); *id.* at 152 (suggesting that “it may be worth considering multiple anchors before attempting to make a final estimate” or decision); Orr & Guthrie, *supra* note 52, at 611 (“[S]tudies suggest that anchoring can affect negotiation. Opening offers, policy limits, damage caps, and other starting figures appear to influence outcomes at the bargaining table.”); *id.* at 624 (“Negotiators who are aware of anchoring can—and should—use this information to their advantage in at least two ways. First ... by setting high goals to themselves prior to the negotiation. Second ... by opening with high demands (or low offers) when they are at the bargaining table.”); John Richardson, *How Negotiators Choose Standards of Fairness: A Look at the Empirical Evidence and Some Steps Toward A Process Model*, 12 HARV. NEGOT. L. REV. 415, 426 (2007) (“[O]nce we adopt an idea or a number, we look for reasons to adjust it. While we may move in the direction suggested by our subsequent analysis, we tend to move less than we should ... Second, once we hear an idea we tend to look for supporting or confirming information, and ignore disconfirming information.”).

made.<sup>54</sup> Unless the opposing attorney completely rewrites the draft, all changes will be made from the starting point of the initial draft. Although difficult and perhaps costly, this could occur, and no advantage will have been realized from preparing the initial draft with one-sided terms.

The anchoring effect, however, suggests that changes to the baseline (the initial draft) proposed by the opposing attorney will be affected by the existence of the initial draft. Thus, even if the opposing attorney is determined to rewrite the contract completely and resist the positions outlined in the initial draft, cognitive science findings suggest that the existence of initial values or terms in the contract will influence the opposing attorney's revisions, even those made on a wholesale basis.<sup>55</sup> For example, one could imagine two contract drafts prepared by the buyer, one that proposes a three-year period within which to bring lawsuits against the seller and one that proposes a seven-year period. The anchor of seven years as opposed to three years may be expected to influence the opposing attorney's advice to her client and subsequent revision.<sup>56</sup> Based on cognitive science findings, one would expect the opposing attorney to respond with a term that is closer to seven years as opposed to three years, even though there is no rational reason for such to be the case and even if the opposing attorney's preliminary position with respect to contractual limitations is the same in each situation.<sup>57</sup>

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<sup>54</sup> It has been recognized, for example, that there are advantages in being the drafter aside from considerations such as anchoring. See FREUND, *supra* note 47, at 26–27 (“The fact is that there are so many elective opportunities in drafting a contract—choices in the introducing and phrasing of concepts, the omission of certain language, the deliberate use of ambiguity, and so on—that a fair number of your resultant edges are bound to slip by the critical gaze of even the most astute adversary counsel”).

<sup>55</sup> KAHNEMAN, *supra* note 49, at 304 (“Many of the messages that negotiators exchange in the course of bargaining are attempts to communicate a reference point and provide an anchor to the other side.”); Richardson, *supra* note 53, at 427 (“A number of studies have shown that negotiators are affected by anchoring as much as individual decision-makers are.”); Fritz Strack & Thomas Mussweiler, *Heuristic Strategies for Estimation Under Uncertainty: The Enigmatic Case of Anchoring*, in FOUNDATIONS OF SOCIAL COGNITION: A Festschrift in Honor of Robert S. Wyer, Jr. 79, 80 (Galen V. Bodenhausen & Alan J. Lambert eds., 2003) (noting that “the number that starts the generation of a judgment exerts a stronger impact than do subsequent pieces of numeric information”).

<sup>56</sup> Orr & Guthrie, *supra* note 52, at 625:

[I]t is worth observing that research on anchoring suggests that negotiators can benefit from starting with even more self-serving positions, even positions that they cannot possibly justify. This seems particularly true when the opposing negotiator is relatively inexperienced in the kind of negotiation at hand and when the offeror expects the recipient of the offer to possess relatively little information about the value of the item being negotiated. *Id.*

<sup>57</sup> This is based purely on the anchoring effect upon the opposing attorney and does not consider what the result of client interaction or input might be. If the opposing party is adamantly against a term beyond one year, then it may not matter whether

An even more extreme example is the difference between asking for nothing and asking for something. For example, the drafting attorney may believe that it will be unlikely for the non-drafting attorney to accept a limitation on damages provision in favor of the drafting attorney's client. In such an instance, one option for the drafting attorney is not to include any limitation on damages provision, since that is where the drafting attorney believes that the parties will end up. The anchoring effect, however, suggests that simply asking for the limitation on damages provision by including it in the initial draft makes it more likely that some sort of limitation on damages provision will be included, even if not in the desired form.<sup>58</sup> This may seem obvious (*i.e.*, it is obvious that if the provision favoring one party is not included in the first draft, it is unlikely that the second party will insert it), but it must be recalled that in each instance, the non-drafting party and the non-drafting party's attorney are assumed to have the same position or attitude with respect to the limitation on damages provision.<sup>59</sup> There is no rational reason, therefore, for the non-drafting attorney to accept the limitation on damages provision in *any* form. Nevertheless, if a provision of a particular type is included, the anchoring effect suggests that it is more likely that such a provision, even in a weaker form, will ultimately end up in the final agreement.

One could also imagine "bundling" the anchor effect by drafting an agreement that has many one-sided provisions as opposed to just a few. By dropping the anchor in deeper water, it may be more likely that the non-drafting attorney will concede on more points or not achieve the position desired *ex ante*. For example, imagine three different contracts: (i) a contract that specifies a three-year period within which to sue for damages and a narrow definition of what constitutes recoverable damages, (ii) a

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the initial draft proposes a three-year term or seven-year term. On the other hand, the anchoring effect could also be suffered by the opposing party, meaning that including a higher term (the seven year term) would also influence the opposing party when instructing her attorney how to respond to the initial draft. One could also argue that such a response is rational. For example, one could argue that the client for whom the buyer's attorney is preparing the draft cares more about the period of time to bring claims (since a longer term was proposed), which would suggest that the seller's attorney is merely responding rationally to the signal from the buyer that the period of time is important by agreeing to a higher term. This does not, however, necessarily have to be true (or, even if true, otherwise negate the effect or its importance). One could imagine two buyers who would each like at least a three-year term, in which instance one would imagine that the draft containing the seven-year term has a better chance of ending up with a provision that is satisfactory.

<sup>58</sup> Orr & Guthrie, *supra* note 52, at 597 (noting that, as a result of anchoring, "we are often unduly influenced by the initial figure we encounter when estimating the value of an item").

<sup>59</sup> Other mitigating factors, such as the desire to appear cooperative or willing to trade one unfavorable provision for another, are similarly ignored for purposes of this example.

contract that specifies a seven-year period within which to sue for damages and a narrow definition of what constitutes recoverable damages, and (iii) a contract that specifies a seven-year period within which to sue for damages and a broad definition of what constitutes recoverable damages. Perhaps the two provisions act as one anchor, which would suggest that the contract described in (iii) would yield the best result for the buyer's attorney drafting the contract (again, assuming that the seller's attorney has the same *ex ante* position with respect to these issues before receiving the draft).<sup>60</sup>

In other contexts, where it has not been established which party will prepare the first draft, we should expect a significant battle. This would reflect parties' implicit understanding that the first stake in the ground will be hard to move too far, or at least as far as it would be if the other party were permitted to hammer in the first stake.<sup>61</sup>

## B. *Status Quo Bias*

Related to the anchoring effect is the status quo bias. The status quo bias describes the tendency of individuals to prefer the status quo even if the status quo does not efficiently allocate rights.<sup>62</sup> In other words, individuals may resist proposing change even if the initial position or

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<sup>60</sup> Daniel A. Crane, *Mixed Bundling, Profit Sacrifice, and Consumer Welfare*, 55 EMORY L.J. 423, 439 (2006):

A diversified firm may be able to exploit this decisional quirk by offering a package price on a series of differentiated goods with varying degrees of salience to consumers ... A high- or low-value perception with respect to the first item in the package may anchor the consumer's perception with respect to the remaining items in the bundle, inducing a different valuation for the overall package than if the customer had considered the varying items in the bundle separately. *Id.*

<sup>61</sup> Richard Birke & Craig R. Fox, *Psychological Principles in Negotiating Civil Settlements*, 4 HARV. NEGOT. L. REV. 1, 40–41 (1999) (describing the effect of the anchoring bias and reciprocity norms and its effect on negotiating tactics). Of course, to the extent there is a power disparity between the principals, control of the initial document likely is in and of itself a significant advantage to the drafting party. See also Danielle K. Hart, *Contract Law Now—Reality Meets Legal Fictions*, 41 BALT. L. REV. 1, 20 (2011):

Because contracts are made binding ... the party that gets to dictate or impose terms during contract formation will usually get to keep and use those terms in the event of any subsequent contract dispute. Clearly, the party that has the ability to impose terms during contract formation is the party with the bargaining power to do so.

<sup>62</sup> Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 625 (1998) (describing how, as a result of the status quo bias, "people systematically favor maintaining a state of affairs that they perceive as being the status quo rather than switching to an alternative state, all else being equal"); Kahan & Klausner, *supra* note 50, at 359 (noting the "psychological preference for the present state and corresponding bias [the endowment effect] against either 'buying' an object that the person does not 'own' or 'selling' an object that a person does 'own'").

course is not desirable. In the contracts context, parties may accept the inclusion of contractual terms that do not necessarily reflect what the parties would have agreed to had they negotiated them exhaustively.<sup>63</sup> For example, contracts may induce deference on the part of the other party simply by being presented in a particular manner.<sup>64</sup>

Consequently, the status quo bias suffered by the non-drafting attorney may result in her proposing fewer changes to the initial draft of the contract.<sup>65</sup> This is true even though the non-drafting attorney has been tasked with a review of the entire contract and the non-drafting attorney would not have included those terms (or drafted them as the drafting attorney did) if the non-drafting attorney had prepared the initial draft.<sup>66</sup>

One could also imagine a cumulative effect with the status quo bias. The longer the initial draft of the contract, the more chances the drafting attorney has for the status quo bias suffered by the non-drafting attorney to have an effect, particularly if the non-drafting attorney is trying to minimize disruptions to the transaction.<sup>67</sup> Similarly, the anchoring effect (enabled by the drafting attorney staking out a more extreme position than actually desired) may compound the status quo bias of the non-drafting

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<sup>63</sup> Robert L. Scharff & Francesco Parisi, *The Role of Status Quo Bias and Bayesian Learning in the Creation of New Legal Rights*, 3 J.L. ECON. & POL'Y 25, 26 (2006) ("Status quo bias exists when decision makers choose to remain with the status quo more often than traditional economic theory would suggest.") (citation omitted); Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583, 1584 (1998) [hereinafter Korobkin, *Inertia*] ("[T]he 'endowment effect,' . . . suggests that the initial allocation of legal entitlements can affect preferences for those entitlements. The consequence is that completely alienable legal entitlements will . . . [e]nd not to be traded—even when such stickiness cannot be explained by transaction costs.").

<sup>64</sup> Kahan & Klausner, *supra* note 50, at 362 (conjecturing that "the terms of a new corporate contract will more closely resemble the standard terms than if the newly formed contract were drafted on a clean, 'neutral' slate. This effect would be present even when the transaction costs of writing a new contract are minimal"); Korobkin, *Inertia*, *supra* note 63, at 1607 (noting the persistence of the status quo bias in contract negotiations regardless of "[w]hether the term associated with inaction was derived from a legal default rule or an industry form contract").

<sup>65</sup> Korobkin, *Inertia*, *supra* note 63, at 1627 ("The inertia theory suggests that . . . it might be possible for a party to convince an opposing negotiator that her uniquely preferred set of contract terms will be enacted through 'inaction' rather than action, even if those terms are uncommon in the industry in question and contrary to legal defaults.").

<sup>66</sup> *Id.* (hypothesizing that "contracting parties can gain a powerful advantage in negotiations by providing a set of draft terms as the basis for detailed negotiations with their contracting partners").

<sup>67</sup> *Id.* at 1592 ("Terms that will govern a contract only if the parties take affirmative steps to establish the term can be more expensive to implement than are terms that operate as a result of inaction. All other things equal, parties should rationally prefer contract terms that require less time and effort to negotiate and draft than alternatives.").

party, resulting in a contract that not only includes undesirable types of provisions (from the non-drafting party's client's point of view), but one that includes particularly undesirable formulations of those provisions (again, from the same point of view).<sup>68</sup>

### C. Regret Theory and Optimism Bias

Regret theory is based on an individual's preference to end up in a worse situation through inaction rather than through action.<sup>69</sup> Thus, individuals' behavior often is influenced by the desire to avoid regret, which can lead to an individual maintaining current behavior or avoiding any act that could lead to regret.<sup>70</sup> Individuals typically feel more regret from a loss arising from engaging in a new activity than from a loss arising from being passive.<sup>71</sup>

An example of how this may be implicated in the contract preparation scenario follows. When the initial draft of the contract is presented to the non-drafting attorney, there are few different outcomes. The non-drafting attorney has to weigh the risks and rewards of an

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<sup>68</sup> Claire A. Hill, *Why Contracts Are Written in "Legalese"*, 77 CHI.-KENT L. REV. 59, 74 (2001) (describing three "psychological dynamics" that provide precedent forms of contracts with "an edge over innovation ... a status quo bias, an 'anchoring effect,' and a conformity bias").

<sup>69</sup> Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for "Asymmetric Paternalism,"* 151 U. PA. L. REV. 1211, 1224 (2003) (describing "the tendency to care much more about errors of commission than about errors of omission, even when there is no obvious normative reason to draw a distinction").

<sup>70</sup> Philip E. Tetlock, *An Alternative Metaphor in the Study of Judgment and Choice: People as Politicians*, 1 THEORY & PSYCHOL. 451, 472 (1991) (describing how "people tend to avoid decisions in which they could appear after the fact to have made the wrong choice, even if in advance the decision appeared correct given the information available at the time"); see also Zacks, *Blame*, *supra* note 6 at 176 (the "status quo bias describes the tendency of individuals to prefer the status quo (the contract as presented) even if the status quo does not efficiently allocate rights").

<sup>71</sup> Tetlock, *supra* note 69, at 472 ("[p]eople feel greater regret for bad outcomes that are the result of new actions than for similar outcomes resulting from inaction."); Korobkin, *Inertia*, *supra* note 62, at 1613 ("Substantial experimental evidence suggests that individuals predict greater regret will follow an action that leads to an undesirable result than a failure to act that leads to the same undesirable act."); see also Marcel Zeelenberg, *The Use of Crying Over Spilled Milk: A Note on the Rationality and Functionality of Regret*, 12 PHIL. PSYCHOL. 325, 329 (1999) (explaining how "we may avoid deciding as a consequence of anticipated regret... simply in order to avoid making the wrong decision"); Eric A. Zacks, *Unstacking the Deck? Contract Manipulation and Credit Card Accountability*, 78 U. CIN. L. REV. 1471, 1476 (2010) (arguing that "[t]he tendency to experience more regret from negative situations resulting from actions an individual takes rather than inaction also may explain [credit card holders'] reluctance to negotiate credit card agreements"); Chris Guthrie, *Better Settle Than Sorry: The Regret Aversion Theory of Litigation Behavior*, 1999 U. ILL. L. REV. 43, 72 (1999) (positing "that litigants seek to make litigation decisions that minimize the likelihood they will experience postdecision regret").

aggressive mark-up as opposed to a passive mark-up. The non-drafting attorney could be very aggressive in her mark-up in the draft on behalf of her client. This aggression could be designed to address (detect and constrain) the opportunistic behavior of the opposing party following execution of the contract.<sup>72</sup> The risk to such aggression is the drafting party suggesting to the non-drafting attorney's client that the non-drafting attorney is "killing the deal."<sup>73</sup> If the revisions are too aggressive, the non-drafting attorney could be signaling that the non-drafting party's client is not easy to work with or is expecting trouble following execution of the contract.<sup>74</sup> If such revisions are not made (because the non-drafting attorney is more passive), however, then the client could be left unprotected in the event that the other party does act opportunistically or issues arise otherwise.

Regret theory suggests that the non-drafting attorney would prefer to be more passive than aggressive, even if being more passive is equally risky (the risk of the client suffering harm in the future) as being more aggressive (the risk of losing, ending up with a bad outcome, or delaying the deal and upsetting the client).<sup>75</sup> This may be particularly true for transactional attorneys, who often pride themselves on being "deal-makers" and not "deal-breakers."<sup>76</sup> Transactional attorneys who vigorously contest every issue may be disfavored, as they may increase the risk of the

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<sup>72</sup> See *supra* Section II.B.

<sup>73</sup> Korobkin, *Inertia*, *supra* note 62, at 1615:

The regret that arises from the occurrence of undesirable events can be understood as a response to what is known as "counterfactual thinking." ... [I]ndividuals are likely to perceive failures to act as relatively normal, or typical, and difficult to avoid, while they are likely to perceive actions as relatively atypical, usually avoidable, and subject to more second-guessing. *Id.*

<sup>74</sup> See *infra* Sections V.B and V.C.

<sup>75</sup> Korobkin, *Inertia*, *supra* note 62, at 1586 ("I contend that a bias in favor of inaction minimizes possible future regret that a negotiator might experience if agreed upon contractual terms turn out, in hindsight, to be undesirable."). This assumes, of course, that the outcomes are equally negative. This is not necessarily true, but it still suggests that there will be some inclination by the attorney to prefer a less disruptive course.

<sup>76</sup> George W. Dent, Jr., *The Role of Lawyers in Strategic Alliances*, 53 CASE W. RES. L. REV. 953, 953 (2003) [hereinafter Dent, *Strategic Alliances*] ("Business people often feel that lawyers are deal breakers, not dealmakers."); Gilson, *supra* note 1, at 242 (calling lawyers "deal killers"); Andrew J. Sherman, Esq., *The Business Lawyer's Expanding Role in Facilitating Small and Mid-Sized Merger and Acquisition Transactions*, BUS. L. BRIEF (AM. U.), Spring 2005, at 13 ("[T]he role of all lawyers to the transaction ... is to work hard to keep the deal on track."), available at <http://www.wcl.american.edu/blr/01/2sherman.pdf>; John M. Tyson, *Drafting, Interpreting, and Enforcing Commercial and Shopping Leases*, 14 CAMPBELL L. REV. 275, 276 (1992) ("The attorney's role in commercial real estate transactions requires a greater use of the counselor portion of the license to practice law. In negotiating, the successful attorney will learn how to be a deal maker, not a deal breaker.").

transaction not occurring.<sup>77</sup> Accordingly, transactional attorneys may be especially prone to “letting issues go” in the draft in the interest of consummating the transaction.<sup>78</sup> The risk to one’s reputation and relationship with the client that arises from being “active” when revising the contract draft will be more impactful on attorney behavior than the risk to the client that arises from being “passive.”

Moreover, the non-drafting attorney may improperly discount the risk of future opportunistic behavior of the opposing party or other problematic contingencies (that may not be prevented because of a passive mark-up of the contract). The optimism bias refers to an individual’s tendency to underestimate the risks involved with a particular activity in which the individual is engaged.<sup>79</sup> Although attorneys and other outside advisors may be somewhat less susceptible to the cognitive biases suffered by their clients, it may be a different scenario when the attorneys are assessing risks that relate to the attorneys as well as their clients.<sup>80</sup> In this instance, the non-drafting attorney may be measuring the risk of a possible future negative outcome for the client (arising from a passive mark-up) against the risk that the client will be unhappy in the present (because the attorney was too aggressive in revising the draft). In such an instance, the attorney may be susceptible to the optimism bias and inaccurately assess

<sup>77</sup> Dent, *Strategic Alliances*, *supra* note 76, at 956–57 (noting that in many situations, “the ... hard bargaining lawyer is not what the client is looking for.... The goal is to obtain the mutual satisfaction of the parties”).

<sup>78</sup> *Id.* at 958 (“[P]roposing detailed terms may provoke suspicion that you’re not going to try to work problems out cooperatively, but you’re going to stand on your contractual rights.”); Richard W. Painter, *The Moral Interdependence of Corporate Lawyers and Their Clients*, 67 S. CAL. L. REV. 507, 545 (1994) (suggesting that lawyers also may lose objectivity to the extent that they become invested (with time and prestige) in a transaction).

<sup>79</sup> Robert S. Adler, *Flawed Thinking: Addressing Decision Biases in Negotiation*, 20 OHIO ST. J. ON DISP. RESOL. 683, 725–28 (2005) (describing the prevalence of the optimism bias); Shmuel I. Becher, *Behavioral Science and Consumer Standard Form Contracts*, 68 LA. L. REV. 117, 147 (2007) (“People are unrealistically optimistic with respect to many important aspects of their lives.”); Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, 35 J. LEGAL STUD. 199, 204 (2006) (“Optimism bias refers to the tendency of people to believe that their own probability of facing a bad outcome is lower than it actually is.”); Robert Prentice, *Contract-Based Defenses in Securities Fraud Litigation: A Behavioral Analysis*, 2003 U. ILL. L. REV. 337, 362–63 (2003); Rachlinski, *supra* note 5, at 1219 (“Psychological research on self-serving biases supports the intuition that it is awfully easy for people to believe things that are in their self-interest to believe.”).

<sup>80</sup> Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 657–58 (1999) (“[I]t seems that the optimistic bias is an indiscriminate and indefatigable cognitive feature, causing individuals to underestimate the extent to which a threat applies to them even when they can recognize the severity it poses to others.”); Rachlinski, *supra* note 5, at 1216 (describing how financial planners help alleviate overconfidence problems when clients select their own investments); *id.* (“Attorneys also can restructure problems for their clients in ways that avoid common cognitive pitfalls.”).



the actual risk of the negative outcome arising as a result of the former course. Compounded with regret theory, the optimism bias and other self-serving biases may act to deter aggressive revisions to a contract draft, suggesting that drafting attorneys (again) may have an opportunity to provide an advantage to their clients by drafting aggressively.<sup>81</sup>

#### D. Complexity and Positive/Negative Information

Cognitive science findings also suggest that human beings have a limited ability to synthesize all information available.<sup>82</sup> For example, it has been demonstrated that individuals will utilize “shortcuts” when faced with a lot of information or complexity in a decision.<sup>83</sup>

Accordingly, a drafting attorney can introduce complexity into a contract with the intention of overwhelming the non-drafting attorney or at least making the cognitive task of reviewing the contract more difficult.<sup>84</sup> One way in which to make the contract more complex is through the use

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<sup>81</sup> Guthrie & Rachlinski, *supra* note 50, at 2044 (“Due to self-serving biases, litigants, their lawyers, and other stakeholders might overestimate their own abilities, the quality of their advocacy, and the relative merits of the positions they are advocating.”).

<sup>82</sup> Russell Korobkin, *The Efficiency of Managed Care “Patient Protection” Laws: Incomplete Contracts, Bounded Rationality, and Market Failure*, 85 CORNELL L. REV. 1, 48 (1999) [hereinafter Korobkin, *Efficiency*] (describing Herbert Simon’s belief “that limitations on individuals’ cognitive ability to process large and complicated data sets bound their capacity to make so-called ‘rational’ decisions, such that boundedly rational behavior is an unavoidable aspect of the human condition”); Cass R. Sunstein et al., *Predictably Incoherent Judgments*, 54 STAN. L. REV. 1153, 1163 (2002) (“It is now well-known that people are not in fact perfectly rational.... Because of the limitations in their ability to process information, boundedly rational agents are not able to maintain a system of beliefs, preferences, and dispositions that is both comprehensive and internally coherent.”); Kojo Yelapaala, *Legal Consciousness and Contractual Obligations*, 39 MCGEORGE L. REV. 193, 215 (2008) (“[B]ecause of limitations in human cognitive capacities and analytical abilities, human decisions often fail to satisfy the utility maximization prediction suggested by the rational choice theory.”).

<sup>83</sup> Korobkin, *Efficiency*, *supra* note 81, at 52 (“When choices become more complex ... decision makers often place relatively more emphasis on the goal of reducing cognitive effort and relatively less emphasis on the goal of achieving accuracy, thus becoming more likely to employ selective or noncompensatory decision-making strategies.”); Yelapaala, *supra* note 81, at 216–17 (“It is argued that heuristic biases, or rules of thumb, appear to be techniques for avoiding the complex task of decision-making either because it is the least costly and/or because of inertia.”).

<sup>84</sup> This has been suggested in other contexts, most notably the consumer contracts. See, e.g., BAR-GILL, *supra* note 5, at 53:

Complexity plays into the imperfect rationality of [credit] cardholders.... Increased complexity may be attractive to issuers, as it allows them to hide the true cost of the credit card in a multidimensional pricing maze.... When the number of price dimensions goes up, the number of non-salient price dimensions can also be expected to go up.

and placement of defined terms. Defined terms in a contract are used as shorthand to refer to longer or more complex terms that are used more than once.<sup>85</sup> For example, instead of referencing the formal name of all of the parties to the contract each time the contract requires such a reference, the contract may define “Parties” (as used in the contract) to refer to all of the parties.<sup>86</sup> These defined terms simplify the contract by not requiring the drafter to redefine a concept every time the concept is used.<sup>87</sup> This often is useful when the defined term refers to a calculation or component utilized in the calculation. In many acquisition agreements, there is a purchase price adjustment based on a complicated formula, which may take into account such factors as the amount of bank account cash deposits and indebtedness for borrowed funds of the target company at the closing.<sup>88</sup> Accordingly, the agreement could define the “Purchase Price Adjustment” (so that the entire calculation for doing the adjustment does not need to be listed each time the adjustment is mentioned) based on the formula for adjusting the “Cash” and “Debt” (so that the lengthier and more specific definitions of “Cash” and “Liabilities” do not need to be listed each time the terms are used).<sup>89</sup>

Although intended to simplify the contract, these defined terms can also add complexity if used strategically. For example, the drafting attorney could include the definition of each capitalized term in a nonsensical place

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<sup>85</sup> See, e.g., Gisela M. Munoz, *Writing Tips for the Transactional Attorney*, PRAC. REAL EST. LAW., May 2005, at 35–36 (“[T]he recitals provide you with an opportunity to define certain terms that will be used repeatedly throughout the contract.”); Joshua Stein, *How to Use Defined Terms to Make Transactional Documents Work Better*, PRAC. LAW., Oct. 1997, at 16:

When the same concept arises more than once, the drafter should express it the same way each time.... As soon as you refer in a document to any concept that takes more than three or four words to explain, and then refer to the same concept a second time, that is the moment to consider setting up a defined term. *Id.*

<sup>86</sup> Munoz, *supra* note 84, at 36 (describing how the introductory paragraph in an agreement can define particular terms so that the shorthand, such as “Tenant” or “Landlord,” can be used throughout the agreement); Stein, *supra* note 84, at 17 (describing party names as being external defined terms that “are unique to the external circumstances of this particular transaction”).

<sup>87</sup> Stein, *supra* note 84, at 16 (“Instead of using the same long string of words a third time (and making sure you use exactly the same long string of words), you simply throw in a quick defined term.”).

<sup>88</sup> See, e.g., COMM. ON NEGOTIATED ACQUISITIONS, MODEL ASSET PURCHASE AGREEMENT § 2.8 (American Bar Association, 2001) (describing and including sample provisions for various purchase price adjustments); R. Bradford Malt, *Form of Purchase Price Adjustment Provision*, in MODEL AGREEMENTS FOR CORP COUNSEL § 66.10 (2011), available at <http://lawschool.westlaw.com/shared/westlawRedirect.aspx?task=find&cite=8+Model+Agrmts+for+Corp+Couns+%c2%a7+66%3a10&appflag=67.12> (setting forth a purchase price adjustment).

<sup>89</sup> Stein, *supra* note 84, at 18 (“Creating defined terms ... helps assure that any ‘laundry list’ will make only a single appearance in the document, in defining a term to use later as a surrogate for the list.... The reader is no longer forced to read, again and again, the same long lists of similar words.”).

(*e.g.*, in a place where the term is not used) or utilize more defined terms than is necessary (so that the reviewing attorney has to look up the definition of many more terms than otherwise would be necessary).<sup>90</sup> This could be enhanced by omitting a separate definitions section that includes internal cross-references for where capitalized terms are not defined (if not otherwise defined in the definitions section) or by the placement of the definition section at the end of an agreement or in a separate ancillary document (*e.g.*, when the non-drafting attorney is not a sophisticated or experienced transactional attorney), which would, in each instance, require a reviewing attorney to flip between pages of the agreement when attempting to determine the meaning of operative provisions (such as a section concerning purchase price adjustments).<sup>91</sup>

Complexity also could be introduced through the use of legalese, contract length (both overall and with respect to each provision or sentence), and the inclusion of many transaction agreements (particularly where cross-references to multiple agreements are contained within each transaction agreement).<sup>92</sup> In each instance, the drafting attorney could intend to make the reviewing attorney's cognitive process when reviewing the draft more difficult, and induce deference or other cognitive "shortcuts" when reviewing the agreement. As the task becomes more difficult, the more unlikely it is that the reviewing attorney will be able to resist all of the provisions as drafted.<sup>93</sup>

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<sup>90</sup> Sheida White, *Mining the Text: 34 Text Features That Can Ease or Obstruct Text Comprehension and Use*, 51 LITERACY RES. & INSTRUCTION 143, 152 (2012) ("Information that provides a key to a pictorial representation or supplements information that is presented semantically in the text; such information increases difficulty [in comprehension of the text] by requiring respondents to refer to a spatially separated piece of information.").

<sup>91</sup> It is customary to include such a definitions section in a lengthy purchase agreement. COMM. ON NEGOTIATED ACQUISITIONS, *supra* note 87, at § 1.1 cmts. ("It is useful, both to reduce the length of other sections and to facilitate changes during negotiations, to list in a section of the acquisition agreement all defined terms that appear in more than one section of the agreement.").

<sup>92</sup> White, *supra* note 89, at 149–50 (describing features, such as syntactic embedding and propositional density, that makes comprehending texts more difficult). White also describes features that "make texts more difficult to understand and use—regardless of the task to be completed—by affecting the way texts are written (the linguistic context) and structured (the nonlinguistic context)," including the number of total words in a document, levels of embedding, cross-references, and sentence length and vocabulary. *Id.* at 150–53.

<sup>93</sup> Russell Korobkin, *The Borat Problem in Negotiation: Fraud, Assent, and the Behavioral Law and Economics of Standard Form Contracts*, 101 CAL. L. REV. 51, 78 (2013) ("When drafters want to discourage reading, they can increase the costs of doing so by increasing the length and opacity of their standard forms."); Jeff Sovern, *Toward a New Model of Consumer Protection: The Problem of Inflated Transaction Costs*, 47 WM. & MARY L. REV. 1635, 1660–61 (2006) (criticizing the inflation of transaction costs by sellers, such as by increasing contract complexity, to deter buyer detection of unfavorable terms).

The drafting attorney may also consider the power of silence in a contract.<sup>94</sup> In an extreme example, an individual may find it difficult to determine what is missing.<sup>95</sup> Therefore, a drafting attorney may find it advantageous to omit a type of term than to draft a one-sided provision (to the extent possible). For example, rather than proposing a high limitation on damages recoverable from the drafting attorney's client, it may be more advantageous to exclude any limitation on damages or similar provisions in the initial draft if the drafting attorney believes that the reviewing attorney will be unable to detect the absence of such provisions.<sup>96</sup> By not calling attention to the type of provision that might exist, a drafting attorney may achieve a better result by omitting the category provision altogether. This may be particularly true for complex contracts and for non-drafting attorneys that are not sufficiently familiar with a particular type of transaction.<sup>97</sup> The non-drafting attorney may be unable to detect the missing

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<sup>94</sup> See generally, Ying-Ju Chen & Xiaojian Zhao, *Solution Concepts of Principal-Agent Models with Unawareness of Actions*, 4 GAMES 508, 509 (2013) ("The novel feature that arises from the agent's unawareness is that there is room for the principal to determine what to announce/include in the contract...."); Ronald Fagin & Joseph Y. Halpern, *Belief, Awareness, and Limited Reasoning*, 34 ARTIFICIAL INTELLIGENCE 39, 40 (1988) (critiquing particular models for knowledge and belief because of assumptions about "logical omniscience"). As Fagin and Halpern note, "in real life people are certainly not omniscient," in part often because of a lack of awareness (if one is not aware of a particular concept in the first place) or not focusing on all issues simultaneously. *Id.* at 40–41; accord Emel Filiz-Ozbay, *Incorporating Unawareness into Contract Theory*, 76 GAMES & ECON. BEHAV. 181, 185–90 (2012) (describing how insurers can strategically use the unawareness of buyers in insurance contracts by either increasing or not addressing such unawareness); David M. Sanbonmatsu et al., *The Role of Prior Knowledge and Missing Information in Multiattribute Valuation*, 51 ORGANIZATIONAL BEHAV. & HUM. DECISION PROCESSES 76, 77 (1992) ("[D]ifficulty is often encountered in the processing of nonoccurrences or nonevents. People do not readily detect and identify the absence of important features.").

<sup>95</sup> Filiz-Ozbay, *supra* note 93, at 181 ("When the insuree reads a contract offered by the insurer, she may become aware of some new aspects of the uncertainty and start taking them into account."); accord Chen & Zhao, *supra* note 93, at 509 ("[S]ince the contract follower (hereafter the *agent*) is not [under their model] fully aware of all aspects relevant to the contractual relationship, the contractual proposer (hereafter the *principal*) may strategically disclose only a subset of relevant aspects in the contract at his own benefit.") Consequently, the contract drafter may have additional discretion or flexibility *ex post* if the agent was not aware of the issue as addressed (or not addressed) in the contract. *Id.* at 514.

<sup>96</sup> Chen & Zhao, *supra* note 93, at 509 (noting that the "contract offer may serve as an *eye-opener* that broadens the agent's [the contract reviewer] vision and allows the agent to get a better understanding of the entire picture").

<sup>97</sup> *Id.* ("While confronted with these unawareness issues and the potential exploitation by others, the strategic decisions of contracting parties critically depend on their *sophistication*."). Accordingly, "[t]he higher cognitive effort the agent spends *ex ante*, the more likely she is able to identify a contractual trap given that there is indeed a trap. Thus, the principal must take into account the agent's cognitive effort and the possible consequences upon designing the contract." *Id.* at 510.

limitation, and the drafting attorney's client is thereby advantaged.<sup>98</sup> Accordingly, omitting terms may be a powerful one-sided "provision" in an initial draft of a contract.

### E. *Reciprocity, Contrast, and Loss Aversion*

An important influence upon human decisions is the "rule for reciprocation," which is the tendency of individuals to feel obligated to pay someone in the future for something that she has done for us.<sup>99</sup> The compulsion to repay someone is a powerful force that often can be used to induce others to agree to otherwise undesired requests.<sup>100</sup> For example, studies show that providing someone with a gift, however valueless or undesired, will influence their decision to accede to a later request, like agreeing to make a charitable donation upon solicitation.<sup>101</sup> In the written contract context, the drafting attorney does not provide a "gift" to the opposing attorney, so it may appear that the influence of reciprocity is not important.

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<sup>98</sup> *Id.* at 509 ("A naive contracting party may take the contract offer as given and passively expand her view of the world to include all the terms in the contract of which she was previously unaware."); *see also* Sanbonmatsu et al., *supra* note 93 ("One consequence of the failure to recognize the absence of information is that people may not moderate their judgments as they tend to do when the incompleteness of knowledge is recognized. In addition, they may have more confidence their judgments than would have been the case if the absence of important information had been detected.").

<sup>99</sup> ROBERT B. CIALDINI, *INFLUENCE: THE PSYCHOLOGY OF PERSUASION* 17 (1st ed. 1993) ("The rule says that we should try to repay, in kind, what another person has provided us."); *see also* James R. Holbrook, *Using Performative, Distributive, Integrative, and Transformative Principles in Negotiation*, 56 *LOY. L. REV.* 359, 368 (2010) ("This rule [of reciprocity] states that, when one party acts in a specific way, the other party likely will react similarly."); Russell Korobkin, *A Positive Theory of Legal Negotiation*, 88 *GEO. L.J.* 1789, 1821–22 (2000) [hereinafter Korobkin, *Legal Negotiation*] ("Perhaps the most common behavioral norm invoked in the negotiation process is reciprocity. When one person takes some action on behalf of another, it is assumed that the favor will be returned."); Peter Reilly, *Resistance is Not Futile: Harnessing the Power of Counter-Offensive Tactics in Legal Persuasion*, 64 *HASTINGS L.J.* 1171, 1192 (2013) ("Through reciprocity, people tend to repay in kind what others have provided them."); Yelapaala, *supra* note 81, at 221 (asserting that "[c]ooperation and reciprocity appear to be not only pervasive across cultures but also to be species-typical").

<sup>100</sup> CIALDINI, *supra* note 98, at 21 (noting that "[t]he rule possesses awesome strength, often producing a 'yes' response to a request that, except for an existing feeling of indebtedness, would have surely been refused"); Adler, *supra* note 78, at 728 (describing the power of the norm of reciprocity in evoking undesired concessions); Barry Goldman, Esq., *The Psychology of Mediation*, IV *NAELA J.* 115, 118 (2008) (suggesting evolutionary psychology as the basis for the strength of the reciprocity norm, which developed to solve the problem of how to induce cooperation among members of a species).

<sup>101</sup> CIALDINI, *supra* note 98, at 21; Korobkin, *Legal Negotiation*, *supra* note 98, at 1822 (describing how fundraisers distribute free return-address stickers in order to induce potential donors to donate).

The reciprocity rule, though, does not require an actual initial gift to be effective.<sup>102</sup> Instead, “[a]nother consequence of the rule ... is an obligation to make a concession to someone who has made a concession to us.”<sup>103</sup> By making a larger request followed by a smaller request, the requesting individual is often able to secure affirmative responses to the smaller request, even though the smaller request would have been refused if the larger request had not preceded it.<sup>104</sup> Thus, individuals can be influenced not based on desire in relation to the request but instead to the framing or presentation of the request.<sup>105</sup> The reciprocity rule works in this instance because the requesting party makes a “gift” of a concession (moving from the larger request to the smaller request), and the party receiving the request and concession is influenced accordingly.<sup>106</sup>

It is in this manner that the reciprocity rule can be utilized when drafting the initial draft of the contract. Drafting attorneys should prepare written contracts that outline more extreme positions than those ultimately desired by the client.<sup>107</sup> If, as might be expected, the extreme positions are

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<sup>102</sup> CIALDINI, *supra* note 98, at 36 (noting that this “is more subtle than the direct route of providing that person with a favor and then asking for one in return; yet in some ways it is more devastatingly effective than the straightforward approach”); Korobkin, *Legal Negotiation*, *supra* note 98, at 1822 (describing different nominal gifts that can induce reciprocity).

<sup>103</sup> CIALDINI, *supra* note 98 at 37; Korobkin, *Legal Negotiation*, *supra* note 98, at 1822 (“The person who fails to reciprocate commits a social faux pas, which can lead to social ostracism and derision.”).

<sup>104</sup> CIALDINI, *supra* note 98, at 37 (noting an example of how “[he] changed from noncompliant to compliant when [the requester] changed from a larger to a smaller request, even though [he] was not really interested in either of the things [the requester] offered”); Goldman, *supra* note 99, at 119 (“In other words, the reciprocity norm is so strong that it is possible to get people to give you things you want by giving them things they do not want and did not ask for.”); Korobkin, *Legal Negotiation*, *supra* note 98, at 1823 (noting that “it is not always clear whether the reciprocity norm requires *equivalent* concessions”); Reilly, *supra* note 98, at 1226 (suggesting that individuals may be able to resist unattractive options only by evaluating all anchors separately).

<sup>105</sup> CIALDINI, *supra* note 98, at 37; Birke & Fox, *supra* note 61, at 46 (noting that “the attractiveness of potential agreements may be influenced by the way in which gains and losses are packaged”).

<sup>106</sup> CIALDINI, *supra* note 98, at 38 (“Provided that you have structured your requests skillfully, I should view your second request as a concession to me and should feel inclined to respond with a concession of my own”); Holbrook, *supra* note 98, at 370 (“The negotiator can avoid such an impasse [a breakdown in bargaining] by understanding that the norm of reciprocity requires each party to make a productive move to continue to narrow the gap between them.”).

<sup>107</sup> CIALDINI, *supra* note 98, at 38 (describing the “rejection-then-retreat technique”); Korobkin, *Legal Negotiation*, *supra* note 98, at 1822 (“A common negotiating tactic is to make an extreme opening offer, perhaps one that is far outside of the bargaining zone, in the hopes of then invoking the reciprocity norm to reach an advantageous deal point.”); Rudolf Vetschera et al., *An Analytical Approach to Offer Generation in Concession-Based Negotiation Processes*, 23 GROUP DECISION & NEGOT. 71, 78 (2014) (describing typical negotiation formulas based on initial offers followed by a series of concessions).

rejected by the reviewing attorney, then the drafting attorney can “retreat” to the desired position. This concession should be expected to be interpreted as a “gift” that will influence the reviewing attorney to agree to the desired position.<sup>108</sup> In addition, the contrast principle suggests that the reviewing attorney will be influenced by the appearance of the desired position alongside of the initial extreme position.<sup>109</sup> By comparison, the desired position will seem less extreme than it otherwise would have (if the extreme position had not been presented at all).<sup>110</sup> The contrast principle and reciprocity rule thus can work together to influence the reviewing attorney if the initial extreme position in a draft is followed by a concession, even if the concession is unrelated.<sup>111</sup> The concession can influence through perception as a gift, while the concession makes the position retreated to appear less extreme.<sup>112</sup> Thus, as in other negotiations, the initial positions presented in the first draft of the contract may be a way to obtain actual concessions from the other side.<sup>113</sup>

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<sup>108</sup> CIALDINI, *supra* note 98, at 38; Korobkin, *Legal Negotiation*, *supra* note 98, at 1823 (describing how concessions from an initial bargaining position can induce the opposing party to make concessions).

<sup>109</sup> CIALDINI, *supra* note 98, at 11–12 (describing how the “contrast principle ... affects the way we see the difference between two things that are presented one after another. Simply put, if the second item is fairly different from the first, we will tend to see it as more different than it actually is”); Chris Guthrie, *Using Bargaining for Advantage in Law School Negotiation Courses*, 16 OHIO ST. J. ON DISP. RESOL. 219, 232 (2000) [hereinafter Guthrie, *Negotiation Courses*] (describing how “contrast effects” and the “reciprocity norm” support making “optimistic, rather than moderate, opening offers in many negotiations”); Reilly, *supra* note 98, at 1225 (describing the “door-in-the-face” influence, which “involves making a request so large it is very likely to be rejected. However, immediately following the rejection, a smaller request is made [and is more likely to be accepted]”).

<sup>110</sup> CIALDINI, *supra* note 98, at 42; Guthrie, *Negotiation Courses*, *supra* note 108 (“Psychologists have discovered that people tend to evaluate an option more favorably when it is compared to an inferior option than when it is evaluated in the absence of such options.”); Reilly, *supra* note 98, at 1226 (noting that a “large request presents a high reference anchor against which the smaller, follow-up request can be favorably judged”).

<sup>111</sup> Birke & Fox, *supra* note 61, at 51–52 (discussing the importance in negotiations of the knowledge that “people tend to reciprocate acts of kindness, even when the original kindness is uninvited and of no value to the recipient”).

<sup>112</sup> CIALDINI, *supra* note 98, at 42 (“Not only will [a] five-dollar request [after a larger ten-dollar request] be viewed as a concession to be reciprocated, it will also look to you like a smaller request than if [the requester] had just asked for it straightaway.”); Guthrie, *Negotiation Courses*, *supra* note 108, at 233 (describing the combined use of contrasts and reciprocity).

<sup>113</sup> CIALDINI, *supra* note 98, at 40 (noting how “[l]abor negotiators, for instance, often use the tactic of beginning with extreme demands that they do not actually expect to win but from which they can retreat in a series of seeming concessions designed to draw real concessions from the opposing side”); Birke & Fox, *supra* note 61, at 51–52 (suggesting that attorneys negotiating a civil settlements should “make an optimistic first offer in order to leave room for concessions that will be expected by the other side (in response to concessions that they will make).

In this scenario, loss aversion also may be relevant. Loss aversion refers to a greater desire for parties to avoid losses than to seek gains.<sup>114</sup> Both parties will generally be seeking to avoid suffering losses in what may appear to be a zero-sum game.<sup>115</sup> When responding to the initial draft of the contract, the non-drafting party will be seeking particular concessions from the drafting party and seeking to avoid particular losses imposed upon his client. For example, the drafting party may have proposed a non-competition covenant to be binding upon the non-drafting party's client. If the non-drafting party seeks to remove the covenant or reduce the scope or term of the covenant, then the non-drafting party will realize a gain. The drafting attorney's client, however, will suffer a corresponding loss to the extent of such removal or reduction. Accordingly, the drafting attorney needs to be able to create "reference points" that permit the negotiation over the painful allocation of "losses" to be as favorable as possible.<sup>116</sup> For example, the non-competition covenant may be unimportant to the drafting party. The portrayal, true or not, of this provision as important to the drafting party's client can influence the non-drafting party (and client) to make concessions in other areas of the contract or even to concede the existence of some weaker form of the non-competition covenant.<sup>117</sup>

Accordingly, the drafting party should attempt to stake out as many possible positions in the initial draft, even if many of those positions are not important to the drafting party's client. The multitude of positions communicate "reference points" to the other side that can be used as "bargaining chips" to be conceded and portrayed as concessionary losses

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Second, it is important to resist the temptation to reciprocate meaningless or negligible concessions."); Guthrie, *Negotiation Courses*, *supra* note 108, at 233 ("Starting optimistically also permits the party making the opening offer to capitalize on the reciprocity norm, an informal social rule that says 'we should try to repay, in kind, what another person has provided us.'").

<sup>114</sup> KAHNEMAN, *supra* note 49, at 302 ("Loss aversion refers to the relative strength of two motives: we are driven more strongly to avoid losses than to achieve gains."); Korobkin, *Inertia*, *supra* note 62, at 1620 ("Loss aversion theory posits that the utility consequences to individuals of suffering a 'loss' from a reference point will be greater than an equivalent 'gain' from the same reference point. If losses loom larger than gains, it follows logically that anticipated regret would loom larger than anticipated rejoicing.").

<sup>115</sup> KAHNEMAN, *supra* note 49, at 304 (noting the difficulty in negotiations involving a "shrinking pie. . . because they require an allocation of losses"); Birke & Fox, *supra* note 61, at 44 (describing the difficulty negotiators may have (because of loss aversion and other factors) in making effective "tradeoffs necessary for them to achieve joint gains").

<sup>116</sup> KAHNEMAN, *supra* note 49, at 304 ("Many of the messages that negotiators exchange in the course of bargaining are attempts to communicate a reference point and provide an anchor to the other side.").

<sup>117</sup> *Id.* at 305 ("Because negotiators are influenced by a norm of reciprocity, a concession that is presented as painful calls for an equally painful (and perhaps equally inauthentic) concession from the other side.").



later.<sup>118</sup> The drafting party also should stake out positions that communicate significant attachment to these various positions. A seven year non-competition covenant to be imposed on the non-drafting attorney's client communicates a much higher level of attachment (by the drafting attorney's client) to the covenant than a one year term would. By signaling a higher level of attachment to different provisions and then making concessions with respect to those terms that are unimportant to the client, the drafting attorney may find it easier to obtain concessions in the areas that are important to the client. Even if the drafting attorney's client does not desire a non-competition covenant from the other party, cognitive science suggests that the drafting attorney should include such a covenant and one that (falsely) communicates its importance to the non-drafting attorney (and client).

The initial draft of a contract could also be an information-seeking device.<sup>119</sup> Based on the response received by the opposing counsel, the drafting attorney can attempt to ascertain the level of sophistication of the opposing counsel as well as the desire by the opposing party to consummate the transaction. This information could be known, of course, such as in the instance of where a large company is bidding to purchase another company while utilizing the services of a large corporate law firm. In other instances, though, the drafting attorney may utilize an aggressive draft where the parties or attorneys are not as familiar.

Thus, the initial draft is an important tool that is capable of establishing a position capable of being accepted that is more favorable than actually desired (the reviewing attorney could always accept it) as well as provide a position from which to retreat and increase the likelihood that the desired position is accepted. This tool provides a significant advantage from both a psychological and structural standpoint.<sup>120</sup>

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<sup>118</sup> *Id.* at 304 (“The messages [during negotiations] are not always sincere. Negotiators often pretend intense attachment to some good ... although they actually view that good as a bargaining chip and intend ultimately to give it away in an exchange.”); Goldman, *supra* note 100, at 119 (describing the practice of labor negotiators “bringing in a laundry list of demands to collective bargaining negotiations. . . . They are there so they can be conceded, and so that the concession can prompt a reciprocal concession from the employer on an issue that has real importance to the union”).

<sup>119</sup> Wendi L. Adair & Jeanne M. Brett, *The Negotiation Dance: Time, Culture, and Behavioral Sequences in Negotiation*, 16 *ORG. SCI.* 1, 35 (2005) (“[I]t is not surprising that negotiators begin negotiations by testing whether the other party is going to be competitive or cooperative before they begin revealing information about positions and interests that should move them toward agreement but could make them vulnerable if the other is competitive.”).

<sup>120</sup> CIALDINI, *supra* note 98, at 45:

By beginning with a [larger] request, I really can't lose. If you agree to it, I will have gotten [more] from you [than] I would have settled for. If, on the other hand, you turn down my initial request, I can

## IV. THE SITUATION OF CONTRACT REVIEW

A drafting attorney should also be cognizant of the situation in which the opposing attorney is operating. There is a growing body of literature that is instructive as to the influence that one's situation has upon one's actions, as opposed to the classical idea of the rational actor with unfettered free will. This Section will explore the different situational pressures, as well as moral hazards, faced by the reviewing attorney.

A. *Situational Pressures*

In general, people are subject to the fundamental attribution error, which is the error individuals make when determining the cause of their own and others' behavior.<sup>121</sup> Individuals typically ascribe the blame for others' behavior to "internal" or "dispositional" factors, while attributing their own negative behavior to external causes.<sup>122</sup> Instead of recognizing the

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retreat...and, through the... reciprocity and contrast principles, greatly enhance my likelihood of success. Either way, I benefit; it's a case of heads I win, tails you lose. *Id.*

*Accord* Charles B. Craver, *The Negotiation Process*, 27 AM. J. TRIAL ADVOC. 271, 283 (2003) ("When in doubt, negotiators should select more, rather than less, extreme opening positions. It is far easier to retreat from excessive positions than it is to counteract the negative impact of inappropriately diminished offers.").

<sup>121</sup> LEE ROSS & RICHARD E. NISBETT, *THE PERSON AND THE SITUATION: PERSPECTIVES OF SOCIAL PSYCHOLOGY* 4 (1991) (describing the fundamental attribution error as "[p]eople's inflated belief in the importance of personality traits and dispositions, together with their failure to recognize the importance of situational factors in affecting behavior"); Jonathan Baron & John C. Hershey, *Outcome Bias in Decision Evaluation*, 54 J. PERSONALITY & SOC. PSYCHOL. 569, 569 (1988) ("We are ingenious in 'discovering' the defect of character we believe would account for a person's misfortune.") (quoting Antoine Arnauld, *THE ART OF THINKING: PORT-ROYAL LOGIC* 285 (1964)); Neal R. Feigenson, *The Rhetoric of Torts: How Advocates Help Jurors Think About Causation, Reasonableness, and Responsibility*, 47 HASTINGS L.J. 61, 127 (1995) ("[T]he 'fundamental attribution error' [is] the tendency inappropriately to attribute the behavior of another person to her corresponding dispositions or traits (i.e., 'the sort of person she is') rather than to the circumstances in which she finds herself, including role demands.") (citation omitted); David C. Funder, *Errors and Mistakes: Evaluating the Accuracy of Social Judgment*, 101 PSYCHOL. BULL. 75, 78 (1987) (describing "the putative tendency for people to overestimate the influence of attitudes and personality on behavior, and to underestimate the power of the situation. It is typically demonstrated by experiments that show how subjects will draw inferences about the personalities of rating targets on the basis of insufficient information") (citations omitted); Roger C. Park, *Character at the Crossroads*, 49 HASTINGS L.J. 717, 738 (1998) (noting that the error "causes human decision-makers to attribute too much importance to dispositions, and to overlook situational influences").

<sup>122</sup> Feigenson, *supra* note 121, at 86 ("People tend to attribute other people's behavior and its (negative) consequences to those people's enduring dispositions or traits, while attributing their own behavior and its (negative) consequences to the circumstances."); Daniel T. Gilbert & Patrick S. Malone, *The Correspondence Bias*, 117 PSYCHOL. BULL. 21, 21 (1995) ("When people observe behavior, they

influence of the situation for another's behavior or unfortunate outcome, an outside observer typically will instead determine that the other person's actions or outcome were caused by the other person's underlying personality.<sup>123</sup>

If, however, the drafting attorney is aware of the power of the situation, then she can exploit the situation to her advantage and to the detriment of the non-drafting attorney (and the non-drafting attorney's client).<sup>124</sup> Knowledge of such constraints or pressures facing opposing counsel can be helpful in securing favorable contractual terms.

For example, the non-drafting attorney's client may be highly motivated to engage in the proposed transaction with the drafting party's client. This is an issue that the drafting attorney can uncover by inquiring with her client.<sup>125</sup> There may be obvious reasons, then, for the opposing party to signal its willingness to cooperate and work constructively with a new prospective transaction partner. When beginning a new relationship or proposing a transaction, it may be important to "sell" the other party on

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often conclude that the person who performed the behavior was predisposed to do so—that the person's behavior corresponds to the person's unique dispositions—and they draw such conclusions even when a logical analysis suggests they should not.”).

<sup>123</sup> Gilbert & Malone, *supra* note 121, at 22 (“[W]hen people do precisely what the physical environment or the social situation demands, dispositional inferences are logically unwarranted. This simple rule is eminently reasonable, but, as with the interstate speed limit, someone seems to have neglected to tell the drivers.”); Prentice, *supra* note 79, at 404 (“Personal factors tend to drift to the fore, whereas situational factors tend to fade into the background.”); Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 VA. L. REV. 1387, 1444 (1983) (explaining one example of the fundamental error is “to attribute an honest act to an honest disposition rather than to the presence of factors that encourage honesty such as the monitoring of behavior or the need for the approval of others”).

<sup>124</sup> Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. PA. L. REV. 129, 333 (2003) (noting that “people systematically—and often quite erroneously—attribute causation, responsibility, and blame to the most visible actors in a given situation,” which is compounded by mistakenly “assuming that action is attributable to disposition, rather than situation”); Tetlock, *supra* note 70, at 464 (“People prefer dispositional explanations because such explanations typically come first to mind, and people rarely consider less obvious situational ones.”). This Article suggests that, as in other contexts, where sellers of products and services “will respond to market incentives by manipulating consumer perceptions in whatever manner maximizes profits,” Hanson & Kysar, *supra* note 79, at 743, we should expect sellers to respond to the same market incentives to prepare contracts to manipulate non-drafting attorney perceptions and responses.

<sup>125</sup> Similarly, the attorney would want to obtain information from her client as to whether the drafting attorney's client otherwise has more bargaining power or leverage in the transaction.

such characteristics in order to secure the relationship or transaction.<sup>126</sup> Thus, the non-drafting attorney's client may be reluctant to send back a revised draft with a lot of comments, or one that otherwise suggests the non-drafting attorney's client will be a difficult negotiating party, not to mention a difficult transaction or relationship partner.<sup>127</sup> Consequently, the non-drafting attorney's client may instruct her attorney to employ a "light touch" to the agreement when revising it. Armed with the knowledge that her client has superior bargaining power with respect to the desire to consummate the transaction, the drafting attorney can prepare a more one-sided contract than what might be possible or preferred if the parties were situated differently.

Similarly, in private auctions for the sale of a company, the selling company's broker often requires a bid that includes the proposed purchase price as well as a complete "mark-up" of the draft purchase agreement prepared by the selling company's attorney.<sup>128</sup> In this instance, it is clear that any prospective bidders are interested in the transaction, and that the seller has leverage where multiple bidders are present.<sup>129</sup> Prospective bidders may be reluctant to "lose" the auction because their revisions to the draft purchase agreement suggest that they may be difficult to work with and may cloud the possibility of a closing.<sup>130</sup> This may be particularly true to the extent that particular purchase agreement provisions do not relate to

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<sup>126</sup> See Adair & Brett, *supra* note 119, at 35 (describing one approach that negotiators take by disclosing "a little sensitive information about their preferences and priorities to signal cooperation and the willingness to develop trust").

<sup>127</sup> Dent, *Strategic Alliances*, *supra* note 76, at 954 (noting that some clients "want a simpler contract because they don't want the hard bargaining that will erode trust").

<sup>128</sup> Steven L. Good & Sheldon Gottlieb, *Real Estate Auctions: A Guide for the Seller's Lawyer*, 2 PROB. & PROP. 41, 42 (1988) (noting that, in an auction for real estate, "the seller's lawyer prepares the sales contract *before* the auction and the contract is generally not subject to negotiation. In effect, the roles of the lawyers are reversed; the seller's lawyer drafts the contract for sale and the buyer's lawyer approves or disapproves the contract's format"); Steven L. Good & Celeste M. Hammond, *Real Estate Auctions – Legal Concerns for an Increasingly Preferred Method of Selling Real Property*, 40 REAL PROP. PROB. & TR. J. 765, 772 (2006) (discussing process for preparing the purchase agreement in a real estate auction).

<sup>129</sup> Schuyler Carroll & Ronni Arnold, *Understanding Buyer and Seller Concerns for Transactions Involving Distressed Businesses*, in BUYING AND SELLING DISTRESSED BUSINESSES: LEADING LAWYERS ON EVALUATING ASSETS AND IDENTIFYING BUYERS, NEGOTIATING DEALS, AND ADVISING DIRECTORS AND OFFICERS ON FIDUCIARY DUTIES 1 (2009) ("[I]n a contested auction, which is an auction with multiple bidders, a bidder has less leverage than an auction in which there is only one buyer. The business terms of the transaction will reflect this dynamic.").

<sup>130</sup> *Id.* (noting that, in a contested auction, "[a] simplified offer makes the bidder's proposal as attractive as possible to the seller and other interested parties which, in turn, fewer representations and warranties setting the parameters within which a transaction will be approved").

the “core” business deal (such as purchase price calculation and timing).<sup>131</sup> Accordingly, the bidders’ attorneys may be pressured to make very few revisions and only in “important” areas. The selling company’s attorney, cognizant of the pressures faced by such attorneys, can draft a contract that is advantageous in the “important” areas as well as those likely to be ignored by opposing attorneys drafting under such pressure.<sup>132</sup>

Time pressure may also be a situational constraint on the reviewing attorney’s ability to resist a one-sided draft.<sup>133</sup> If the other attorney will not

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<sup>131</sup> Nancy S. Kim, *Evolving Business and Social Norms and Interpretation Rules: The Need for a Dynamic Approach to Contract Disputes*, 84 NEB. L. REV. 506, 543 (2005) (noting that, with respect to form contracts, “[r]equests to change seemingly inconsequential provisions may be met with suspicion or hostility”).

<sup>132</sup> Good & Gottlieb, *supra* note 128, at 42 (“In such circumstances [a contested auction], the seller’s lawyer is often tempted to draft a contract heavily weighted toward the seller.”). Interestingly, prospective bidders may include memoranda that explain the proposed changes to the revised draft. See Scott B. Connolly et al., *Auctions: From the Bidder’s Perspective*, DRINKER BIDDLE, <http://www.drinkerbiddle.com/Templates/media/files/publications/2010/auctions-from-the-bidders-perspective.pdf> at 3 (“Instead of sending a full mark-up of the acquisition agreement, the bidder may be required to or may choose to submit an issues list indicating specific points that the bidder wants to negotiate.”). These memoranda, by describing the bidders’ motivations and justifying the changes, may be important less as a strictly informative device regarding the nature of the changes as opposed to a signaling device designed to inform the sellers that the bidders have good intentions, are thoughtful negotiators, and will be good transaction partners. *Id.* at 4 (“The decision of how to comply with bidding procedures [such as the seller’s request for a full and final mark-up] is often determined by the bidder’s perceived leverage and desire to close the transaction.”). Such memoranda or issues lists also, from the bidders’ perspective, do not commit the bidders to a particular formulation of the draft and allow the bidders to revise with more thought and possibly more bargaining power after the bid has been secured. *Id.* (“Because submitting a full mark-up is virtually impossible without the acceptance of significant risk and the incurrence of substantial costs by a bidder, many bidders opt to submit detailed mark-ups or issues lists that focus on conceptual issues rather than specific language.”).

<sup>133</sup> Gerrit M. Beckhaus, “Comply or Explain”—A Flexible Mechanism to Countervail Behavioral Biases in M&A Transactions, 21 U. MIAMI BUS. L. REV. 183, 191 (2013) (“In general, M&A [merger and acquisition] transactions involve a multitude of typically highly complex decisions, which are made under great uncertainty and time pressure.”); E.A. Bernstein, *supra* note 17, at 232 (“Contracting decisions are almost always made in the shadow of a time deadline.”); Kim, *supra* note 130, at 543 (describing how sellers may require bidder’s offers (and deposits) to be conditioned upon closing by a certain date, “so a delay [arising from buyer changing the agreement or otherwise] might enable the seller to keep the buyer’s good faith deposit or put the property back on the market”); Donald G. Gifford, *A Context-Based Theory of Strategy Selection in Legal Negotiation*, 46 OHIO ST. L.J. 41, 66–67 (1985) (noting the power of time pressure in the context of settling lawsuits). The power of time to review has been noted in the consumer contract context. For example, it is has been noted that consumer contracts are often presented to consumers in those situations where they are unwilling or unlikely to spend a lot of time reviewing the contract. See Shmuel I. Becher & Tal Z. Zarsky, *E-Contract Doctrine 2.0: Standard Form Contracting in the Age of Online User Participation*, 14 MICH. TELECOMM. & TECH. L. REV.

have a lot of time to review, consider, and revise the initial contract draft, then the drafting attorney may be inclined to draft a more lengthy and complicated draft. This may occur, for example, in the company auction situation where the bidding client has determined that, after completing its preliminary financial and other due diligence, it would like to make a bid. In such an instance, the reviewing attorney may not be engaged to review the purchase agreement until the client has made such a decision.<sup>134</sup> To the extent that the decision to bid is made late in the process, the reviewing attorney may not have sufficient time to complete an exhaustive review of the contract prior to the deadline for submitting bids.<sup>135</sup> Again, the leverage of multiple bidders, fear of losing the transaction for “non-business” (legal) reasons, and time may influence or impact a reviewing attorney’s ability to resist a one-sided contract draft.<sup>136</sup>

Other situational pressures may exist as well. In the next Section, this Article addresses situational pressures that may exist because of a moral hazard facing the reviewing attorney.

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303, 313 (2008) (noting that “in many instances consumers enter SFCs [standard form contracts] under unfavorable circumstances... frequently characterized by noise, time constraints and vendors’ attempts to manipulate consumers”); Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 446 (2002) (“Reading and understanding boilerplate terms is difficult and time consuming for consumers. . . [T]o make matters worse, consumers commonly encounter standard forms when they are in a hurry.”); Erin A. O’Hara, *Choice of Law for Internet Transactions: The Uneasy Case for Online Consumer Protection*, 153 U. PA. L. REV. 1883, 1920–21 (2005) (“The difficulty with the process by which consumers enter into standard-form arrangements stems from the fact that the vendor . . . presents those terms in a take-it-or-leave-it fashion to the consumer who is in a hurry to complete the transaction.”).

<sup>134</sup> Alan R. Kravets, *Going, Going, Gone! Real Estate Auctions in the 90s*, 7 PROB. & PROP. 38, 42 (1993) (“Few buyers are represented at any auction because of the cost and because there is nothing to negotiate. . . . After the auction, the buyer’s lawyer will represent the buyer as if in a typical real estate closing.”). This may explain why sellers are able to propose initial drafts of purchase agreements, as opposed to traditional sales, where “[t]he etiquette in an acquisition is for the purchaser’s attorney to draft the basic agreement.” FREUND, *supra* note 47, at 27.

<sup>135</sup> Birke & Fox, *supra* note 61, at 56 (“Opportunities often seem more valuable when they are less available. . . . Threats to freedom can take the form of time limits, supply limits, and competition. In negotiation, these tactics can be a particularly effective means of gaining compliance.”); Gifford, *supra* note 133, at 66 (“Social scientists’ research shows that time pressures result in lower demands, faster concessions, and lower aspiration levels.”).

<sup>136</sup> Beckhaus, *supra* note 132, at 191 (“The time pressure [in mergers and acquisitions transactions] results from the costs of the transaction process, potential competitors for the target company, the respective market situation, a fixed time frame or the need for secrecy [which]...increase the probability of irrational behavior in decision-making processes. . . .”); Birke & Fox, *supra* note 61, at 56 (“Savvy negotiators can dramatize their alternatives by entertaining competing bids, or they can strategically impose artificial time limits for negotiation.”).

### B. *The Moral Hazards Facing the Non-Drafting Attorney*

It also is worthwhile for the drafting attorney to be aware of the moral hazard that may face the non-drafting attorney. The non-drafting attorney, as any other economic agent (in this instance of the client), may be inclined, and is able, to act in a manner that is not optimal for the client.<sup>137</sup> Because the client is relying on the non-drafting attorney for advice with respect to the draft, the non-drafting attorney has more information and control regarding whether the non-drafting attorney is performing as the client would desire.<sup>138</sup>

In this instance, however, the attorney's interests may not be aligned with the client's (presumably, securing the most favorable contractual terms).<sup>139</sup> The attorney, for example, may desire to utilize a lower level of care when reviewing the initial draft of the contract than otherwise might be desired by the principal, in particular where the attorney is being compensated on a per-transaction (or contingent) as opposed to an hourly basis.<sup>140</sup> Where the underlying compensation for the attorney is the

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<sup>137</sup> See *supra* Sections II.B and II.C.

<sup>138</sup> See *supra* Sections II.B and II.C; Richman, *supra* note 7, at 77 (noting the conventional conclusion that "whenever we observe contracts that appear to be suboptimal, we blame agency costs" arising from attorney-client relationships).

<sup>139</sup> E.A. Bernstein, *supra* note 17, at 235 (describing the different risk profiles of attorneys and clients, and resulting agency problems); J.M. Klein, *supra* note 3, at 352 ("[T]he ability of a lawyer to impact his or her own compensation creates the potential for a conflict of interest."). For example, attorneys "may fear losing the client if a remote contingency occurs more than they fear transaction breakdown that can be attributed to opposing counsel, they may not know the client's circumstances, or they may simply be inexperienced." E.A. Bernstein, *supra* note 17, at 235-36. Similarly, attorneys may fear losing the client following the consummation of a particular transaction (such as when a public company is taken private), which provides an economic incentive to "scuttle the deal." J.M. Klein, *supra* note 3, at 355-56.

<sup>140</sup> Hill, *supra* note 67, at 71 (describing law firm resistance to innovations in existing forms of contracts as being based on lawyers' desire to avoid a "bad outcome for which the lawyer is blamed." Consequently, "avoiding a bad outcome is tantamount to a good enough outcome"); Anthony J. Sebok & W. Bradley Wendel, *Duty in the Litigation-investment Agreement: The Choice Between Tort and Contract Norms When the Deal Breaks Down*, 66 VAND. L. REV. 1831, 1852 (2013) (comparing the incentives of attorneys in hourly and contingent compensation arrangements and concluding that contingency fee arrangements incentivizes attorneys "to work fewer hours to maximize the effective hourly rate obtained by working on the client's matter. A contingent fee arrangement therefore leads to suboptimal levels of attorney effort"); George B. Shepherd & Morgan Cloud, *Time and Money: Discovery Leads to Hourly Billing*, 1999 U. ILL. L. REV. 91, 107 (1999) ("Under a fixed-fee contract, the lawyer has an incentive to economize on her time. . . . By spending additional time on this client's matter, the lawyer sacrifices income that she could have earned by instead devoting the time to other matters.").

same regardless of the amount of effort, the incentive to shirk is heightened.<sup>141</sup>

Similarly, the non-drafting attorney presumably has an interest in maintaining the client relationship. If the attorney is being used for one transaction, presumably the attorney might be used for a future transaction.<sup>142</sup> As a result, there is a desire to please the principal (the client). This might induce the non-drafting attorney to revise the contract in a manner that minimizes the possibility of the revisions disrupting the transaction. Of course, the attorney will certainly lose the client if it turns out that the attorney's revisions were not sufficient to protect the client's interests, but the attorney may view that possibility as a low probability risk.<sup>143</sup>

In another context, the drafting attorney may be a client referral source for the reviewing attorney or even the referral source for the contract review matter itself, which also can lead to a conflict of interest for the reviewing attorney.<sup>144</sup> For example, if there are multiple investors in a

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<sup>141</sup> Of course, a different conflict of interest is present where the attorney is compensated on an hourly basis. Shepherd & Cloud, *supra* note 140, at 108 (“In contrast, the hourly contract creates a strong incentive for the lawyer to conduct unnecessary work. . . . Moral hazard exists because the lawyer profits from each additional hour that the lawyer devotes to the client’s matter, regardless of whether the additional hour benefits the client.”).

<sup>142</sup> This is particularly true when law firm partners feel less secure in their positions at the firm based on changed economic conditions or firm structures. See Stephen M. Bainbridge, *The Tournament at the Intersection of Business and Legal Ethics*, 1 U. ST. THOMAS L. J. 909, 921 (2004):

“Compensation based on business generation means that partners are more vulnerable to shifting market conditions. Factors over which a lawyer may have no control, such as the merger of her client into another company, a corporation’s decision to assign more work to its legal department, or a downturn in a particular economic sector (witness Internet start-ups) may significantly reduce her compensation.”

*Id.* (quoting Milton C. Regan, Jr., *Corporate Norms and Contemporary Law Firm Practice*, 70 GEO. WASH. L. REV. 931, 937 (2002). Bainbridge concludes, with respect to reporting client fraud, “[b]ecause an individual partner is even more likely than a firm to be dependent on billings to a single major client, the eat-what-you-kill phenomenon makes it highly unlikely that such a partner will risk antagonizing key clients absent the proverbial smoking gun—and maybe not even then.” *Id.* These same considerations, however, can apply in the contract review context. Attorneys desiring to keep important clients happy about the transaction may be reluctant to kill a transaction by being too aggressive when reviewing the draft acquisition agreement.

<sup>143</sup> See *supra* Section III.C for a discussion of regret theory and optimism bias.

<sup>144</sup> Carolyn M. Dillinger, *Use Strategic Networking to Build Your Customized Book of Business*, ORANGE COUNTY LAW., July 2008, at 10 (describing the referral relationship that often exists between different types of attorneys), available at <http://www.ocbar.org/OCLawyer/ArticleIndex/2008ArticleIndex.aspx>; Glen McMurry & Adam Krumholz, *What's Next? The Transition from Law School to Solo or Firm Practice*, FED. LAW., May 2012, at 18 (advising new attorneys to



project, the lead investor's attorney may represent the investor group with respect to agreements between the seller and the group. As to matters between the investors such as a shareholder agreement, however, it is common for each investor to retain her own attorney to avoid conflicts of interest.<sup>145</sup> In such an instance, the lead investor or the lead investor's attorney may suggest particular attorneys for the other investors to utilize with respect to the shareholder agreement. In such an instance, an attorney that was referred the matter may be inclined to suggest fewer revisions to avoid disruption of the transaction or otherwise displease the referral source, with the underlying desire to secure future referrals.<sup>146</sup> The party or attorney that referred the matter to the reviewing attorney may also be able to take advantage of the norm of reciprocity discussed in Section III.E *supra*, which suggests that the reviewing attorney may feel obligated to concede or otherwise "give" something to the referral source because something (the contract review matter or other client matters) was given to her.

## V. CONSTRAINTS ON DRAFTING ADVANTAGES

The cognitive biases and situational pressures discussed in this Article are not to suggest that the reviewing attorney is unable to understand or resist contracts drafted to exploit them. There also may exist similar biases or situational pressures facing the drafting attorney that constrain such opportunistic behavior.

### A. Expertise

First, the general expertise of a reviewing attorney, particular of an experienced attorney, may suggest an ability to resist some of the cognitive biases that may otherwise be suffered by their clients, such as the optimism

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develop relationships with other attorneys to build their referral network); Deborah L. Rhode, *Institutionalizing Ethics*, 44 CASE W. RES. L. REV. 665, 681-82 (1994) (noting lawyers' "priority on maintaining good relationships with other members of their community or participants in the legal process").

<sup>145</sup> 1-1 Corporate Attorney's Practice Guide § 1.04 ("For example, if the owner-managers wish to enter into partnership agreements, shareholder agreements, or employment agreements, each party should have independent counsel during the negotiation of these agreements, unless the conflict is waived by all of the parties.").

<sup>146</sup> Rhode, *supra* note 144, at 682:

Inadequate representation of client interests is also common where lawyers place priority on maintaining good relationships with other members of their community or participants in the legal process. If zealous pursuit of any single matter will antagonize individuals whose continuing cooperation or client referrals is important, attorneys may adjust their partisanship accordingly.

bias.<sup>147</sup> This may be particularly true when the attorney is not facing a moral hazard or other situational pressures, such as those described in Section IV *supra*.<sup>148</sup> Experience in a particular area may enable a higher level of analysis because of the lower level of cognitive effort that an expert requires to address an issue.<sup>149</sup> This may permit reviewing attorneys to resist time pressure and issue complexity as advantages for the drafting attorney.<sup>150</sup>

Knowledge of the general market practices may also inform a reviewing attorney as to what revisions are “appropriate” and unlikely to be challenged or perceived as disruptive to the transaction.<sup>151</sup> For example,

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<sup>147</sup> Orr & Guthrie, *supra* note 52, at 622 (noting that their study “results suggest that this influence [anchoring] is somewhat diminished by the presence of additional information and negotiator experience”); Rachlinski, *supra* note 5, at 1217 (“Experienced attorneys have had many chances to develop superior ways of evaluating decisions and using these decisionmaking skills for their clients’ benefit.”); *but see* Birke & Fox, *supra* note 61, at 10 (“People are especially susceptible to anchoring bias when they have little relevant experience or knowledge. However, expertise alone fails to provide protection from this tendency.”); Zev J. Eigen & Yair Listokin, *Do Lawyers Really Believe Their Own Hype, and Should They? A Natural Experiment*, 41 J. LEGAL STUD. 239, 241 (2012) (“Substantial optimism bias persists among lawyers even when they are randomly assigned to sides of a case.”); Richardson, *supra* note 53, at 427 (“A number of studies have shown that negotiators are affected by anchoring as much as individual decision-makers are.”); Orr & Guthrie, *supra* note 52, at 627 (“This is not to say that lawyers are pure ‘rational actors’ who are impervious to the effects of anchoring and other heuristics and biases; in fact, lawyers, like others, are susceptible to such biases.”).

<sup>148</sup> Orr & Guthrie, *supra* note 52, at 626 & 628 (finding “evidence that information and expertise can mitigate the effects of an anchor” and noting “lawyers may be better able than others to resist biases, including anchoring”); Rachlinski, *supra* note 5, at 1216–17 (“Attorneys situated somewhat outside of the decisionmaking environment, can see multiple frames and other perspectives more easily than clients.”). Lawyers may especially be well-positioned to resist the effects of anchoring because they “are likely to feel accountable to their clients,” and research suggests such feelings help avoid anchoring. Accordingly, “[t]his suggests that lawyers are more likely to avoid anchoring than their clients (and, indeed, that lawyers may be better able to avoid anchoring when negotiating on behalf of clients than when negotiating on their own behalf).” Orr & Guthrie, *supra* note 52, at 628.

<sup>149</sup> *See generally* Joseph W. Alba & J. Wesley Hutchinson, *Dimensions of Consumer Expertise*, 13 J. CONSUMER RES. 411, 423 (1987) (describing multiple hypotheses that explain experts’ cognitive advantages over novices).

<sup>150</sup> *See id.* at 423 exhibit 3 (“Time pressure, information complexity, and low motivation inhibit analytic processing; however, because product familiarity generally reduces cognitive effort and frees up cognitive resources, these effects are greater for novices than for experts.”).

<sup>151</sup> *See id.* at 437 exhibit 5 (hypothesizing that “the superior ability of experts to identify relevant information results in qualitative differences in the information used by experts and novices during memory-based decision making”); Susan T. Fiske, Donald R. Kinder & W. Michael Larter, *The Novice and the Expert: Knowledge-based Strategies in Political Cognition*, 19 J. EXPERIMENTAL & SOC. PSYCHOL. 381, 384 (1983) (“[N]ot only do experts know more than novices, but

statistics concerning the prevalence of different types of purchase agreement provisions, such as indemnification limits, purchase price adjustments, and warranty survival periods are published on a regular basis.<sup>152</sup> Not only will these statistics inform the reviewing attorney as to what revisions are appropriate or are readily accepted, the statistics themselves also may induce the reviewing attorney to suggest the particular changes.<sup>153</sup> These statistics suggest to reviewing attorneys particular norms within an area of practice, and an otherwise uncertain reviewing attorney may tend to rely on the “social proof” of what others do or have done in such situations.<sup>154</sup> Attorneys also might be particularly risk-averse and overestimate the likelihood of remote events, which suggests that they will be somewhat conservative in their advice with respect to a contract draft.<sup>155</sup>

### B. *The Situation of Drafting*

The situation of negotiating the contract may also act to constrain the drafting attorney’s behavior. Just as the non-drafting attorney does not want to be perceived by her client as holding up the transaction, this same pressure exists for the drafting attorney. Accordingly, acting as an important constraint on the ability of drafters to insert extreme positions is the risk of appearing unreasonable. The drafting attorney faces the risk that the reviewing attorney will inform her client that the drafting attorney’s

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also their knowledge is more tightly organized. Thus, despite the greater quantity of information available to them, they can handle it more efficiently.”).

<sup>152</sup> See, e.g., WILSON CHU & JESSICA PEARLMAN, *MERGERS & ACQUISITIONS: MKT. TRENDS SUBCOMM.*, A.B.A., 2013 U.S. PRIVATE TARGET M&A DEAL POINTS STUDY; MATT SPENCER ET AL., HOULIHAN LOKEY MERGERS & ACQUISITIONS GROUP, *PURCHASE AGREEMENT STUDY FOR TRANSACTIONS COMPLETED IN 2012 AND PRIOR YEARS (2013)*, available at <http://www.hl.com/email/pdf/cf2013-purchase-agreement-study.pdf>.

<sup>153</sup> See Sanbonmatsu et al., *supra* note 93, at 78 (“[R]elative to novices, experts are more aware of the relevance of information for performing a given cognitive task and are more likely to attend to all relevant information.”); Fiske et al., *supra* note 150, at 385 (“All this suggests that experts, compared to novices, may take inconsistent information more into account when making inferences from material that is a balanced mix of consistent and inconsistent information. . . . If so, experts also should recall greater amounts of inconsistent information.”).

<sup>154</sup> Chris Guthrie, *Principles of Influence in Negotiation*, 87 MARQ. L. REV. 829, 833 (2004) (summarizing these conditions as elucidated by Caldini); PLOUS, *supra* note 53, at 201–02 (describing conformity effects). Lawyers and other experts also may be better equipped to detect the (purposeful) absence of important provisions in a draft of a contract. See Sanbonmatsu et al., *supra* note 93, at 78 (“Because of their greater sensitivity to relevant information, individuals high in knowledge may be more likely to detect the absence of relevant information than individuals low in knowledge.”).

<sup>155</sup> Hill, *supra* note 67, at 73 (“Many lawyers in large firms, even some at relatively senior levels, seem to assign higher probabilities to certain bad events than is warranted. . . . If many lawyers overestimate the probability of bad events, they might practice law defensively.”).

draft is extremely one-sided and that the drafting attorney's client should be so informed, which could result in the drafting attorney being viewed as an impediment to the transaction. Preparing one-sided agreements can also destroy the ability of the drafting attorney to utilize reciprocity when making "concessions" later on in negotiations. If the drafting attorney's initial position is too extreme, then the reviewing attorney may not interpret any concessions made from such positions as being "real" and deserving of reciprocation.<sup>156</sup>

This relates to the importance of the contract as a trust-building device. It has been suggested that the utility of certain contracts lies not in their ability to obtain legal enforcement of promises but instead to create a secure relationship between two parties.<sup>157</sup> To the extent the drafting attorney short-circuits the process by proposing a draft that does not allow such a relationship to develop, the drafting attorney's client may be displeased or unlikely to utilize the attorney in the future.

### C. Benefits vs. Costs of a One-Sided Contract

The benefits of a one-sided contract that can be secured based on

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<sup>156</sup> See *supra* Section III.E for a discussion of reciprocity. See also Adler, *supra* note 78, at 770 ("[R]ecent research suggests . . . that making first offers can markedly improve one's outcome through the strategic use of anchoring."); Robert S. Adler & Elliot M. Silverstein, *When David Meets Goliath: Dealing with Power Differentials in Negotiations*, 5 HARV. NEGOT. L. REV. 1, 75–76 (2000) ("[T]here is virtual unanimity among the experts regarding the size of one's opening offer: it should be as high (or low) as reasonably possible. Doing so . . . capitalizes on findings from psychology."); Birke & Fox, *supra* note 61, at 41 (suggesting that "it is good strategy to make as extreme an opening offer as can be gotten away with, but not so extreme that the offeror appears to be negotiating in bad faith"); Good & Gottlieb, *supra* note 128, at 42 (noting that "an onerous, unfair contract may discourage an otherwise enthusiastic potential bidder and with the result of a poor sale or no sale").

<sup>157</sup> Iva Bozovic & Gillian K. Hadfield, *Scaffolding: Using Formal Contracts to Build Informal Relations in Support of Innovation* 8 (USC Law & Economics Research Papers Series No. C12-3, 2012), available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1984915](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1984915) (citing and agreeing with previous studies indicating the process of negotiating a contract (a legal enforcement mechanism for promises) "endogenously generates a level of trust (and practical information about the value of a joint project) sufficient to support the non-contractible commitments that make for successful collaboration in an environment of high uncertainty"). Bozovic et al. argue that "formal contracting can help to coordinate and improve the efficacy of informal contract enforcement mechanisms such as the threat to terminate a valuable relationship or damage commercial reputation." *Id.* at 5; Dent, *Strategic Alliances*, *supra* note 76, at 954 (noting the tension between an attorney that does not want to be blamed for an incomplete contract which did not anticipate a future problem and the client that wants to develop a successful "strategic alliance"); Mayer & Argyres, *supra* note 31, at 407 (describing one view of contracts as believing that "contracts improve trust because the contracting process promotes expectations of cooperation and generates commitment to the relationship").

knowledge of an unsophisticated, inexperienced, or pressured reviewing attorney may not outweigh some of the risks of doing so. For example, in a sophisticated or complex transaction, it may not be helpful to have an overly complicated agreement if the opposing attorney is not experienced. A contractual advantage does not mean that the reviewing attorney will assist the drafting attorney to consummate the transaction as desired.

For example, a purchase agreement between a buyer and seller often contains representations and warranties of the seller with respect to various issues concerning the seller, including financial, legal, and operational issues.<sup>158</sup> These representations, if breached by the seller, would permit the buyer to sue the seller for damages suffered as a result of such breach.<sup>159</sup> Representations, however, also allow the buyer to conduct due diligence and confirm that previous due diligence matches the representations and disclosures made by the seller in the purchase agreement.<sup>160</sup> In other words, knowledge of the veracity of the representation may be more valuable to the buyer prior to the transaction than after the transaction.<sup>161</sup>

An example is a representation by the seller concerning notices of threatened litigation or audits.<sup>162</sup> Obviously, the buyer would rather have

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<sup>158</sup> FREUND, *supra* note 47, at 148. Freund describes multiple purposes of the representations, including laying “the groundwork for indemnification.” *Id.* at 230–32; Ronald S. Melamed & Edward S. Gusky, *Preparing a Commercial Real Estate Purchase Agreement: The Ins and Outs for the Seller and Purchaser*, 84 MICH. B.J. 32, 34 (2005) (describing the connection between a purchaser’s due diligence and a purchase agreement’s representations and warranties).

<sup>159</sup> MODEL ASSET PURCHASE AGREEMENT, *supra* note 88, at Introductory Comment at § 3 (“[T]he seller’s representations affect the buyer’s right to indemnification by the seller and the shareholders (and other remedies) if the buyer discovers a breach of any representation after the closing”); Rand L. Allen et al., *The Various Types of Transactions and Their Key Characteristics*, DUE DILIGENCE IN GOV’T CONTRACTOR MERGERS & ACQUISITIONS GLASS-CLE 3, 27 (2007) (describing how “a seller bears the economic responsibility for any loss” arising from a breach of a seller’s representation).

<sup>160</sup> MODEL ASSET PURCHASE AGREEMENT, *supra* note 88, at cmt. to § 3 (describing how representations assist the buyer in “obtaining disclosure about the seller before the signing of the acquisition agreement. A thorough buyer’s draft elicits information about the seller and its business relevant to the buyer’s willingness to buy”); Phillip Wm. Lear et al., *Representations, Warranties, Covenants, Conditions, and Indemnities: Stitching Them Together in the Purchase Agreement*, 37 ROCKY MOUNTAIN MINERAL L. INST. 3, 8 (1991) (noting that representations function “as conditions to closing and . . . as protections after closing”).

<sup>161</sup> Lear, *supra* note (“If the representations are untrue at the time of closing, the non-breaching party is not obligated to close.”); MODEL ASSET PURCHASE AGREEMENT, *supra* note 88, at cmt. to § 3 (“The seller’s representations also provide a foundation for the buyer’s right to terminate the acquisition before or at the closing.”).

<sup>162</sup> Nancy Young, *A Model Asset Purchase Agreement*, 43 PRAC. LAW. 33, 52 (1997) (formulating a litigation representation); Allen et al., *supra* note 158, at 33 (describing typical representations); Alan S. Gutterman, 28 Business Transactions

the knowledge regarding any such notices prior to the closing so that the buyer can evaluate the expected exposure and impact of such issues.<sup>163</sup> With such knowledge, the buyer may be unwilling to consummate the transaction on the proposed terms, which suggests that the contract's ability to provide for damages after the closing is insufficient protection for the buyer. Accordingly, if the non-drafting attorney is unable to understand the litigation and audit representation and explain it properly to her client, then the fact that the drafting attorney was able to draft a one-sided contract providing for unlimited redress in the event of a breach may be of little, or at least less, comfort to the buyer.

In addition, a one-sided contract that is designed to exploit the reviewing attorney's review of the contract can also be problematic when the contracting parties have a relationship that survives the closing of the initial transaction. As discussed in Section V.B *supra*, the contracting process may be designed to create a level of trust between the contracting parties, particularly where the parties will have a lengthy relationship.<sup>164</sup> If one of the parties is surprised by the legal meaning of a particular provision (which was enabled due to deficiencies during the contract review process), then the ongoing relationship between the parties may be undercut.<sup>165</sup> The

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Solutions § 111:13 (describing a litigation representation); MODEL ASSET PURCHASE AGREEMENT, *supra* note 88, at § 3.18 (formulating and commenting on a model litigation representation).

<sup>163</sup> *Due Diligence Reviews in Mergers and Acquisitions*, 24 CORP. COUNS. Q. ART 7 (2008) ("If the due diligence process discovers a problem with one of the seller's representations . . . [t]he buyer may have an 'out' and be able to back out of the deal. The buyer may also have a breach of contract suit against the seller.").

<sup>164</sup> Bozovic & Hadfield, *supra* note 157, at 45 ("This is one sense in which we say that the formal contract provides scaffolding for the informal relationship: it supports the formation of the belief structure that underpins trust by reducing ambiguity in the interpretation of behavior."); Carolina Camén, Patrick Gottfridsson & Bo Rundh, *Contracts as Cornerstones in Relationship Building*, 4 INT'L J. QUALITY & SERV. SCIENCES (2012) ("One way to develop commitment and trust could be during the process where the parties discuss the conditions for the relationship . . . The negotiation process functions as a bridge between the parties for reaching a contract and relationship building."); Robert E. Scott, *Conflict and Cooperation in Long-term Contracts*, 75 CAL. L. REV. 2005, 2007 (1987) ("Parties enter into continuing contractual relationships in order to exploit the economic benefits of long-term planning and coordination.").

<sup>165</sup> See Stewart Macaulay, *Non-contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. R. 1 (1963) (finding that corporations do not utilize contracts to manage ongoing relationships); Bozovic & Hadfield, *supra* note 157, at 32 (suggesting that, in some situations, the parties do not negotiate to classify conduct in their contract as a breach "for purposes of settling in the shadow of expected court-awarded damages . . . Rather, the formal reasoning of contract law provides a shared and knowable procedure by which the parties can, independently, arrive at common knowledge classifications of conduct . . . to support an equilibrium in which breach is deterred by the threat of termination of the contract"). Thus, if the parties contemplate an ongoing relationship or one in which the ability to seek legal recourse is unpalatable, then there may be less value in seeking a one-sided contract as opposed to one that clearly reflects the understood and communicated shared beliefs of the parties.

drafting attorney, then, may be inclined to draft an agreement that clearly details each issue for the parties as opposed to obfuscating them.

## VI. CONCLUSION

This Article explores the strategic implications arising from a cognitive and social science perspective of the contract drafting and review process. Traditional accounts of transactional attorneys assume an almost robot-like functionality to the charged tasks of managing transaction costs, including efficiently and effectively drafting and reviewing transaction agreements to address contingencies and other issues. These accounts, however, have not addressed the susceptibility of individual attorneys to cognitive bias and situational pressures that can limit effective representation. This may be particularly problematic if one views the attorney as a necessary agent employed by the client (the principal) that is intended to provide an unbiased outsider's perspective with respect to the transactional issues that arise.

Based on an understanding of the behavioral tendencies of individual attorneys in light of cognitive bias and situational pressure, this Article has described how the drafting attorney may be able to secure particular transactional advantages for her client. Accordingly, knowledge of the variations within the attorney decision-making process in different circumstances could help explain current contracting behavior. The battle over which party will control the drafting process may reflect an understanding not only of the power of the ability to choose the language that will govern the parties' relationship, but also an implicit understanding that setting forth an initial position will influence the opposing attorney's (and opposing party's) response in a manner that may not be expected. As discussed in this Article, the drafting party also can secure advantages for her client if she is aware of the situational pressures facing the attorney reviewing the draft. Both time pressure and the pressure to avoid appearing to be an impediment to a deal can influence the reviewing attorney to avoid being too aggressive in her response to an initial draft. Accordingly, this Article has described many powerful situational and cognitive factors that can influence contract draft review by the opposing counsel.

The critique of contract drafting and review set forth in this Article has important implications for accepted notions of the transactional attorney. First, this Article suggests that reviewing attorneys may not, in certain circumstances, be effective intermediaries or outside advisors. Given that clients employ attorneys to assist them in making decisions based on their superior information or expertise, clients may be poorly served to the extent that cognitive biases and situational pressures limit the ability of the attorneys to utilize such information or expertise. Moreover, these cognitive biases and situational pressures do not exist in a vacuum. A drafting attorney aware of such factors can prepare contracts designed to

exploit them in her client's favor. For that reason, the notion of the transactional attorney as an effective "transaction cost engineer" should be questioned. Under this model, attorneys attempt, presumably in a systematic and rational fashion, to lower the barriers between different parties being able to consummate the transaction as desired. This Article, however, suggests that reviewing attorneys may not respond "rationally" (from the client's perspective) to a draft prepared by the opposing attorney. By attacking the ability of the reviewing attorney to respond in her client's best interests to a contract draft, the drafting attorney may secure transactional advantages but also may undermine the purpose and purported benefit of, or value added by, the reviewing attorney.<sup>166</sup> The idea of the attorney as an "engineer" lowering barriers to the transaction thus is undermined.

More problematically, the reviewing attorney may not only be viewed as an "irrational" or "manipulable" engineer, but she also can be viewed as a transaction cost "distorter." If the draft or context of an agreement influences a reviewing attorney to respond less effectively to her client's interests, then the reviewing attorney may be artificially lowering the transaction costs. In other words, transaction costs or other barriers to the transaction may in fact reflect substantial differences between the parties' positions. To the extent that these differences are resolved because of the reviewing attorney's flawed (irrational, self-interested, or otherwise) decision-making process, the resulting transactions may harm the client's interests. Certain transactions may occur because the reviewing attorney artificially lowered the barriers to the transaction, even though the client would have preferred for such barriers to remain (if properly explained and understood) and the transaction not to occur.

In this sense, the reviewing attorney may be unable to serve as an effective check on the ability of the opposing party to act opportunistically after the contract has been formed. As described in Section IV.B *supra*, the promisor faces a moral hazard to act in her personal interest (to the detriment of the promisee) when performing the promise to the extent that informational and control asymmetries exist between the parties. The contract accordingly has been understood as a mechanism designed to preclude the inclination of a promising party to shirk, hold up or otherwise fail to perform adequately. This Article suggests that strategic drafting may inhibit the reviewing attorney's ability to alleviate the informational and control asymmetries that will exist between the parties after contract formation. For example, if the contract does not allow the promisee to monitor the promisor effectively or to control the promisor's performance through explicit performance parameters or penalties, then the contract's

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<sup>166</sup> Gilson, *supra* note 1, at 244 (discussing how, under a model of distributive bargaining, the transactional attorney's skill is in securing "a greater share of the gain than would have been the case if the lawyers were more evenly matched").



promises may not be performed as desired. The utility of the contract for parties in such situations is undercut and raises the risk and cost of such transactions.

Similarly, the reviewing attorney may be an ineffective monitoring agent in terms of the principal-agent relationship that exists between the two parties prior to contract formation. As I have argued elsewhere, the party preparing the contract can be understood as the economic agent of the opposing party with respect to the task of contract drafting.<sup>167</sup> As an economic agent, the drafting party faces a moral hazard to draft the contract in the drafting party's personal interests instead of serving the principal's (the opposing party's) interests. Accordingly, the opposing party may employ an attorney as an expert designed to alleviate the information and control asymmetries that exist between the opposing parties with respect to drafting the contract. If, however, the attorney is unable *ex ante* to alleviate asymmetries because of strategic drafting as described in this Article, then the contract may be one-sided and permit the opposing party to act opportunistically after the contract has been executed. It may be difficult to determine precisely what relevance, if any, the situational pressure facing attorneys or attorneys' cognitive bias would or should have in the adjudicative setting. Judges may be unsympathetic to an otherwise sophisticated client's assertion that she should not be bound by a contract because her attorney failed to represent her adequately due to the attorney's optimism bias or reluctance to obstruct the transaction.<sup>168</sup> On the other hand, such factors could be relevant in a malpractice lawsuit or an ethics inquiry. In those situations, the adjudicator may take notice of possible cognitive bias, moral hazard, and situational pressure for the reviewing attorney and then determine whether the attorney acted appropriately when reviewing the contract.<sup>169</sup> Without an understanding of these factors, an adjudicator may be unable to recognize improper attorney conduct.

These issues also should be incorporated into legal ethics courses so that law students have a better understanding of possible conflicts of interest that can exist between the attorney and the client (even if such conflicts do not require a formal waiver or remediation). An attorney conscious of the moral hazard she faces when reviewing a contract will be better positioned to represent her client's interests instead of her own. Given the hidden nature of cognitive bias and situational pressure, law students (and attorneys) will otherwise be unaware of how behavior is or may be affected in the transactional setting.

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<sup>167</sup> See, e.g., E.A. Zacks, *Moral Hazard*, *supra* note 32.

<sup>168</sup> See *supra* Sections III and IV for a discussion of various cognitive biases and moral hazards.

<sup>169</sup> See generally Dustin A. Zacks, *Robo-litigation*, 60 CLEV. ST. L. REV. 867 (2013) (describing the firm structures, market forces, cognitive biases, and other situational influences that led to questionable conduct by foreclosure law firms).

Understanding the cognitive limitations and situational influences that affect an attorney's review of a contract is important on a number of levels. It helps explain or predict particular patterns of contracting behavior, such as the tendency of contracting parties to contest which party will prepare the initial draft of the contract. It also suggests particular limitations on the attorney as an effective tool in checking opportunistic behavior, both prior to and after contract formation. This is important as reforms are considered that envision attorneys being able to alleviate one-sided contracts or transactions. Presumably, these reforms are premised at least in part on the idea that attorneys will be effective in reducing the ability of the drafting party (often the party with more bargaining power) to prepare a one-sided contract. This Article suggests, however, that attorneys may be ineffective in doing so, and additional work should be conducted to determine the situations in which attorneys may be deployed most effectively.<sup>170</sup> Accordingly, understanding the decision-making behavior and processes of reviewing attorneys is fundamental to an examination of contracts and contracting behavior.

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<sup>170</sup> See *supra* notes 139–140 and accompanying text.