THE POTENTIAL LEGAL VALUE OF RELATIONAL CONTRACTS IN A TIME OF CRISIS OR UNCERTAINTY

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I
INTRODUCTION

The COVID-19 pandemic and attendant socioeconomic transformations have resulted in significant dislocations in the lives of individuals and organizations. Agreements—especially those relating to supply chain arrangements—have garnered much attention and undergone significant review. Business contracts and the exchanges they embody have been foregone, revised, delayed, and terminated; performance under business contracts has been modified voluntarily and involuntarily. Some of these actions and outcomes have been the subject of legal claims brought by one contracting party or another in courts or administrative tribunals.

Legal counsel involved in dispute resolution, drafting, compliance, and the provision of other business contract advisory services have focused on important terms—including *force majeure* and material adverse change clauses—in contracts involving ongoing commercial relationships (for example, supply chain agreements) or delayed closings (for example, business combination agreements). This has garnered significant attention in the business, legal, and popular press. However, there has been less consideration of how the pandemic and other crises might catalyze a more fundamental review of contract design and drafting principles and practices.

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A co-authored October 2020 *Harvard Business Review* ("*HBR*") article[1] provides a notable exception. The *HBR* article, *An Innovative Way to Prevent Adversarial Supplier Relationships* (referred to in this article as "*Innovative Way*"), promotes the use of "formal relational contracts" as a means of obviating or limiting opportunistic behaviors by contracting parties, including parties contending with cataclysmic events or factors in or outside the business that place significant financial stress on the business and its relations with others. The *Innovative Way* co-authors note that the uncertainties exposed by and emanating from the ongoing COVID-19 pandemic are formative to their proposition.[2] They specifically focus their attention on supply contracts, although their ideas may have broader application. This article preliminarily inspects the claims made in *Innovative Way* from the standpoint of U.S. legal doctrine and lawyering and suggests avenues for future research, with the limited goal of offering legal commentary on a broad-based contract design idea that responds to the need for business operations flexibility in a pandemic or in other times of systemic or individualized crisis.

The inspection proceeds in three additional parts. First, the article briefly describes the concept and context of relational contracting. Next, it summarizes the benefits of formal relational contracting identified in *Innovative Way* and the evidence cited by the co-authors in support of those beneficial aspects of relational contracting. Finally, before offering a summary conclusion, the article offers doctrinal and practical legal observations about the claims made in *Innovative Way*.

II

RELATIONAL CONTRACTS AND CONTRACTUAL PROVISIONS

There are many taxonomies of contracts. One salient, long-standing theoretical conception categorizes contracts as either discrete (also sometimes referred to as transactional)[3] or relational. These categorizations can be a bit squirrely, with dedicated scholars disagreeing on the definitions and the premise for the

1. David Frydlinger, Oliver Hart & Kate Vitasek, *An Innovative Way to Prevent Adversarial Supplier Relationships*, HARV. BUS. REV. (Oct. 8, 2020) [hereinafter Innovative Way], https://hbr.org/2020/10/an-innovative-way-to-prevent-adversarial-supplier-relationships?ab=hero-subleft-3 [https://perma.cc/9VM7-ZKT3]. The ideas on formal relational contracting shared in *Innovative Way* became the focus (along with two other perspectives) of an April 2021 virtual academic symposium on "Relational Contracts: Theory and Practice" sponsored by World Commerce & Contracting, The Centre for Corporate Reputation at Saïd School of Business, University of Oxford, the Stigler Center at the University of Chicago, the Becker-Friedman Institute at the University of Chicago, and the Relational Contracts Workshop. *See Academic Symposium | Relational Contracts: Theory and Practice*, WORLD COM. & CONTRACTING, https://www.worldcc.com/Events/Event-Info/session-altcd/21_04_23_SYMPOSIUM [https://perma.cc/F872-FECQ]; *see also Academic Symposium | Relational Contracts: Theory and Practice*, WORLD COM. & CONTRACTING, https://bfi.uchicago.edu/event/academic-symposium-relational-contracts-theory-and-practice/ [https://perma.cc/P29A-3KMT] (including the conference agenda).

2. *See Innovative Way*, *supra* note 1 ("Given the uncertainty that lies ahead, it is especially important now that companies try to avoid antagonizing the members of their ecosystems. Formal relational contracts, which can turn adversarial relationships into mutually beneficial partnerships, is a proven means to such an end.").

3. For ease of reference, this article uses the term "discrete" to describe these types of contracts.

discrete or relational categorization.

A strictly discrete contract is a legally enforceable agreement in which the parties assent to specific, detailed promises that are designed to govern the whole of their prescribed relationship.[4] Those promises are based on a knowledge of the past and expectations about the future.[5] Discrete contracts are prototypically but not exclusively used for one-off transactions—solitary exchanges between parties that are unlikely to be engaged with each other on a recurrent basis.[6]

This article focuses on relational contracts. As used in this article, a relational contract comprises structures and covenants designed to enable and support parties in an ongoing transactional association—often repeat players in the same community, business, or industry—in productively working through the inevitable vicissitudes impacting their affairs.[7] Most commonly, parties to a relational contract aspire to resolve conflicts in their relations without resorting to judicial enforcement of specific contract terms.[8] Ian R. Macneil, a seminal theoretician of relational contracts, notes that "in relational contracts the benefits and burdens are shared."[9]

Although the precise attributes of relational contracts are defined variously by academic commentators, relational contracts typically are acknowledged to be incomplete, whether by design or, as more narrowly conceived, by default.[10] They

4. *See, e.g.*, Victor Goldberg, *Towards an Expanded Economic Theory of Contract*, 10 J. ECON. ISSUES 45, 53 (1976) ("The discrete transaction model essentially posits that economic actors can ascertain their long-run self-interest and will in one contractual act exchange promises which will appropriately restrict their future behavior for as long a time as is necessary.").

5. *See* Ian R. Macneil, *The Many Futures of Contracts*, 47 S. CAL. L. REV. 691, 801 (1974) ("The ultimate goal of the parties to a pure transaction is to bring *everything* from the past and *everything* from the future into the immediate present, *i.e.*, a two way presentation." (footnote omitted)).

6. *See, e.g.*, IAN R. MACNEIL, THE NEW SOCIAL CONTRACT 10 (1980) (defining a discrete contract as "one in which no relation exists between the parties apart from the simple exchange of goods."); *see also* Melvin A. Eisenberg, *Why There Is No Law of Relational Contracts*, 94 NW. U. L. REV. 805, 816 (2000) ("[T]he obvious definition of a discrete contract is a contract that involves only an exchange, and not a relationship.").

7. *See, e.g.*, Eisenberg, *supra* note 6, at 816 ("The obvious definition of a relational contract is a contract that involves not merely an exchange, but also a relationship, between the contracting parties."); Blake D. Morant, *Contractual Rules and Terms and the Maintenance of Bargains: The Case of the Fledgling Writer*, 18 HASTINGS COMM. & ENT. L.J. 453, 497 (1996) (defining relational contracts by reference to their incompleteness and duration); Donald J. Smythe, *Bounded Rationality, the Doctrine of Impracticability, and the Governance of Relational Contracts*, 13 S. CAL. INTERDISC. L.J. 227, 266 (2004) ("[R]elational contracts provide a means of coping with unforeseen contingencies as they arise, rather than attempting to plan for them in advance.").

8. *See, e.g.*, Michal Shur-Ofry & Ofer Tur-Sinai, *Constructive Ambiguity: IP Licenses as a Case Study*, 48 U. MICH. J.L. REFORM 391, 408 (2015) (noting that parties to relational contracts "are often able to resolve disputes without recourse to the legal system.").

9. Macneil, *supra* note 5, at 782.

10. *See, e.g.*, Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1091 (1981) ("A contract is relational to the extent that the parties are incapable of reducing important terms of the arrangement to well-defined obligations."); Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 271 (1992) ("According to the lawyers, relational contracts usually are incomplete."); *see also* Morant, *supra* note 7.

may be characterized by incompleteness in specific aspects or provide more generalized standards that govern the conduct of the parties in whole or in part. A braided agreement is an example of a contract that is incomplete in specific aspects. Braided agreements prototypically involve early-stage, predicate informational obligations enforced through informal contractual structures and mechanisms.[11] Examples of more generalized contractual standards governing the parties' conduct include commitments qualified by "best efforts" and fairness obligations.[12] The co-authors of *Innovative Way* explicitly invoke relational contracts that employ generalized contractual standards—specifically, fairness obligations.[13] Relational contracts need not be, but often are, conceptualized as long-term agreements.[14]

Importantly, the practical notion of a relational contract derives from theoretical and empirical roots. Specifically, in a 1974 article, Professor Macneil contends that it is a presupposition of contract law that the nature of the engagement between or among parties to a legally enforceable agreement is a discrete transaction.[15] He observes that this legal assumption is faulty because it ignores the reality that the parties to a contract are inherently involved in a relationship that is neither temporally isolated nor substantively limited to the core objective of the parties' legal interactions.[16] A 1963 study published by Stewart Macaulay in the *American Sociological Review* is credited with introducing the notion that business contractual relationships often are not defined by specific, express contractual terms, finding that "while detailed planning and legal sanctions play a significant role in some exchanges between businesses, in many business exchanges their role is small."[17] This article acknowledges and implicitly invokes

11. *See, e.g.*, Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Braiding: The Interaction of Formal and Informal Contracting in Theory, Practice, and Doctrine*, 110 COLUM. L. REV. 1377, 1403 (2010) [hereinafter *Braiding*] ("Braiding uses formal contracts to create governance processes which support iterative joint efforts with low-powered enforcement techniques that partially protect the commitment to collaborate, but do not control the course or the outcome of the collaboration."); Matthew Jennejohn, *Braided Agreements and New Frontiers for Relational Contract Theory*, 45 J. CORP. L. 885, 887–88 (2020) ("In a braided agreement, certain formal contract provisions create information sharing routines, which in turn foster informal governance by (1) making each collaborator's performance more transparent, (2) revealing whether the parties are prone to cheating, and (3) locking the parties into the partnership as they make mutual investments in relationship-specific learning.").

12. *See, e.g.*, Jennejohn, *supra* note 11, at 892 ("In situations where uncertainty often makes future performance obligations difficult to foresee, parties use standard-like terms, such as 'best efforts' provisions, in their agreements. These . . . terms build flexibility into the exchange relationship and, in the event of litigation, . . . invite more searching inquiries of the relational context of an exchange.").

13. *See infra*, note 55 and accompanying text; *see also Innovative Way*, *supra* note 1 ("The contract is not something the parties simply put in a drawer and pull out when something goes wrong; rather they view it as a playbook for working through issues fairly and flexibly.").

14. *See* Jennejohn, *supra* note 11, at 892 ("[L]ong-term contracts are more likely than short-term agreements to fit this conceptualization, but temporal extension per se is not the defining characteristic"); *see also* Morant, *supra* note 7.

15. *See* Macneil, *supra* note 5, at 693 (deriving this conceptualization for the Restatement of Contracts definition of a contract).

16. *Id.* at 694–96 (briefly outlining this argument).

17. Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC.

the rich and evolving theory and empirics that underlie relational contracts (as distinct from discrete contracts) as foundational without interrogating or fully accepting or rejecting the specific claims made in earlier scholarly works.

Although the definitional categorization of contracts as discrete or relational is significant as an analytical tool, no individual contract is entirely discrete or relational.[18] As many have observed, contracts exist across a continuum from completely discrete to wholly relational. Professor Macneil refers to a "spectrum of relational-transactional exchange" in his initial article.[19] Professor Macaulay describes an array of four degrees of contractual planning, from "explicit and careful" through "tacit agreement" and "unilateral assumptions," to "unawareness of the issues."[20] Even if they are not wholly conscious of it, contracting parties and their legal counsel routinely fashion hybrid agreements consisting of discrete and relational terms. Regardless, they may use the discrete or relational categorization as an element of design in structuring their contractual affairs.

The premise that contracts themselves (and, more pointedly, individual provisions within contracts) may be consciously and methodically drafted to be more discrete, more relational, or a blend between the two[21] underlies the argument forwarded in *Innovative Way*. By suggesting that formal relational contracts are advantageous in times of crisis or other uncertainty, the co-authors of *Innovative Way* advocate a contract-drafting solution to defining and enforcing behavioral norms that underlie the transactional relations of the contracting parties and define the scope of their reactions to events or circumstances that put pressure on those relations. Doctrinal legal principles and law practice conventions each play a role in the ultimate efficacy of the recommendation offered in *Innovative Way*, however.

This article explores both doctrinal and practical issues that impact the overall value of the formal relational contract solution posited in *Innovative Way*. Before proceeding with that analysis, the article first offers a summary of the argument made in *Innovative Way*, highlighting the specific benefits of and rationale for promoting formal relational contracting as a valued platform for commercial supply arrangements in times of crisis or other uncertainty.

REV. 55, 62 (1963).

18. *See, e.g.*, Goetz & Scott, *supra* note 10, at 1091 ("The contracts that we actually observe are, of course, neither perfectly contingent nor entirely relational").

19. Macneil, *supra* note 5, at 806 n.320.

20. Macaulay, *supra* note 17, at 57.

21. This blend is expressly acknowledged in the legal academic literature relating to contract law and drafting. *See, e.g.*, Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561 (2015) (exploring original equipment manufacturer master supply agreements that combine aspects of discrete and relational contracts); *Braiding*, *supra* note 11 (describing the interweaving of formal and informal elements into commercial contractual relationships).

III

IDENTIFIED BENEFITS OF FORMAL RELATIONAL CONTRACTING IN UNCERTAIN TIMES

Relational contracting has been advocated as a means of addressing uncertainty in contractual arrangements.[22] Uncertainty in contractual relations is inherent to the process. Contracting parties cannot always know or commit to their respective responses to foreseen and unforeseen events and circumstances at the time of contracting. In establishing their contractual obligations, the parties can provide for these eventualities in a relational contract or can agree that the contract either will remain silent on the relevant contingencies or include purposefully vague language to address the uncertainty.

The benefits of relational contracting as an approach to uncertainty in contractual relations have been variously articulated in the academic literature, which includes commentary from economic, legal, sociological, and business management perspectives expressed through multiple methodological lenses. Lisa Bernstein, for example, has identified four economic advantages of relational contracts—specifically, relational contracts drafted to allow for enforcement without judicial or other third-party intervention. These potential benefits include "decrease[d] contracting costs because of a reduced need for specification," decreased monitoring costs associated with self-enforcement, decreased modification costs in response to changing markets, and decreased transaction costs over the long term.[23] Overall, beneficial risk allocation may be associated with the archetypal long-term nature of relational contracts.[24]

Relational contracting may be most advantageous in specific types of contracts. For example, Professor Macneil extolled the virtues of the shared benefits and burdens of relational contracting in the partnership context, as opposed to a "winner takes all" or other starker potential allocations of risk.[25] Similarly, relational contracting may be advantageous in joint venture contracting.[26] Bilateral

22. *See, e.g.*, Goetz & Scott, *supra* note 10, at 1090 n.4 ("[W]hen transactions are conducted under conditions of uncertainty and complexity, it becomes extremely costly—if not literally impossible—for parties constrained by bounded rationality to describe the complete decision tree at the time of bargaining."); Robert E. Scott, *The Paradox of Contracting in Markets*, 83 LAW & CONTEMP. PROBS., no. 2, 2020, at 71, 75 ("As uncertainty increases, efforts to craft fully state contingent contracts come under pressure. Parties in bilateral markets then turn to more flexible relational contracts . . . .").

23. Bernstein, *supra* note 21, at 614 n.170.

24. *See* Henry N. Butler & Barry D. Baysinger, *Vertical Restraints of Trade as Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory*, 32 EMORY L.J. 1009, 1039 (1983) ("A significant advantage of relational contracting is that it not only provides for the sharing of risks but also a possible reduction of risk. This reduction is possible because the long-term nature of relational contracts reduces the incentives of economic agents to engage in the types of opportunistic behavior that lead, in market-mediated discrete transactions, to transaction failures.").

25. *See* Macneil, *supra* note 5, at 782–83.

26. Steven R. Salbu & Richard A. Brahm, *Strategic Considerations in Designing Joint Venture Contracts*, 1992 COLUM. BUS. L. REV. 253, 259 (1992) ("A more relational approach to contracting sacrifices early specificity of terms in order to gain the flexibility necessary to develop the relationship optimally rather than predictably. The tradeoff, of course, is between coordination and flexibility, and relational

supply contracts that are structured to incorporate flexible, relational commitments may benefit from transaction cost savings and greater business continuity.[27]

The co-authors of *Innovative Way* make a specific case for the benefit of relational supply contracting at times of uncertainty, citing the COVID-19 pandemic and its economic effects as a touchstone.[28] Their argument centers around the capacity that relational contracts have for limiting or avoiding otherwise likely opportunistic behavior that disrupts fluid, efficient supply chain management. Specifically, they observe that, "[f]or procurement professionals at large multinational companies, the temptation is to use their company's clout to pressure suppliers to reduce prices. And when the supplier has the upper hand, it is hard to resist the opportunity to impose price increases on customers."[29] They note that these predictable responses result in a process known as shading, which:

> happens when one party isn't getting the outcome it expects and feels the other party has not acted reasonably. The aggrieved party will react by becoming less cooperative and less proactive in meeting the other's needs (e.g., helping to meet sudden shifts in demand that would entail actions not spelled out in the contract, or imposing higher prices when the business climate shifts and it has the upper hand).[30]

Innovative Way's co-authors argue that the key to avoiding these opportunistic responses to economic and social changes that impact participants in supply chains is a constant, stable alignment of the expectations of those participants as parties to procurement contracts. Their described vision of formal relational contracting is designed to achieve that objective.

Specifically, they advocate "a legally enforceable written contract (hence 'formal') that puts the parties' relationship above the specific points of the deal."[31] This legally enforceable writing has three core components designed to enable the parties to address disruptions in their contractual relations:

- "shared goals and objectives";
- "guiding principles"; and
- "robust relationship management processes."[32]

These components represent a supplement to, rather than a substitute for, the core transactional supply contract components. The guiding principles appear to

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contracting requires acceptance of a precarious zone of non-specificity of contracting.").

27. *See* Scott, *supra* note 22, at 75 n.17 ("Allowing flexibility (or discretion) in relational contracts saves parties the transaction costs from continually having to update or renegotiate price or quantity in light of changed external circumstances. A further advantage of a flexible relational contract is that it permits the parties to 'smooth the bumps' in the inevitable variations in supply and demand that otherwise may threaten short term business disruption.").

28. *Innovative Way*, *supra* note 1 ("The economic impact of the pandemic and the uncertainty about what lies ahead are having a major impact on relations between companies and their suppliers.").

29. *Id.*

30. *Id.*; *see also* Kate Vitasek, Jane K. Winn & Toni E. Nickel, *The Vested Way: A Model of Formal Relational Contracts*, 52 U. PAC. L. REV. 125, 131–32 (2020). It should be noted that another scholar also uses the term "shading" in a different way in the contract breach and enforcement context. *See* Robert E. Scott, *Contract Design and the Shading Problem*, 99 MARQ. L. REV. 1, 12 (2015) (defining "shading" in that context as "behavior that is, in fact, self-interested but appears completely guileless.").

31. *Innovative Way*, *supra* note 1.

32. *Id.*

be especially important to the success of the envisioned supply contract in enforcing the commitments to aligned expectations.[33]

The co-authors of *Innovative Way* acknowledge in various ways the relational nature of their suggested contractual approach to avoiding opportunistic supply chain behaviors. They assume joint recognition of the potential effects of uncertainty and the incomplete nature of the contractual arrangement as a response.[34] They envisage the formal relational supply contract as a living, breathing part of their ongoing relationship of the contracting parties.[35]

How do we know that this proposed form of formal relational supply contract works—that the perceived benefits of relational contracts are beneficial in crises or other uncertain times? The co-authors of *Innovative Way* answer that question by offering anecdotal examples of firms that have adopted this approach.[36] Most pointedly, they offer general observations about the terms and success of a particular contract between a health care facility and a physician group providing care at the facility. They refer to a predecessor *HBR* article they also co-authored (in 2019) and their arguments there, which largely rest on theoretical and pragmatic grounds.[37] That earlier *HBR* article mentions not only shading, but also hold-up behaviors and the applied contract work of two of the co-authors relating to a contract design framework called Vested. Although they represent that they have not conducted a rigorous empirical study of the fifty-seven firms that adopted the Vested approach, they reference anecdotal positive comments.[38]

Notably, a discussion of relevant legal or lawyering principles is almost wholly absent from both *HBR* articles. Both publications emphasize the legal enforceability of the posited supply agreements, indicating that their reference to formal relational contracts is intended to signify legal enforceability.[39] The first *HBR* article notes that "most companies—and their legal counsel in particular—are uncomfortable with informal handshake deals, especially when the stakes are high."[40] *Innovative Way* omits any reference to legal counsel. Apart from these

33. *See id.* ("The guiding principles contractually commit the parties to use proven social norms (e.g., treating each other with honesty and in an equitable fashion), which ensure that the parties will refrain from short-term opportunism.").

34. *See id.* ("The parties embrace the fact that all contracts are incomplete and can never cover all the contingencies that may occur. This time it is a pandemic. Next time it will be something else.").

35. *See id.* ("The contract is not something the parties simply put in a drawer and pull out when something goes wrong; rather they view it as a playbook for working through issues fairly and flexibly.").

36. *See id.* ("Does it really work? The short answer is yes, a number of companies are successfully using it.").

37. David Frydlinger, Oliver Hart & Kate Vitasek, *A New Approach to Contracts*, HARV. BUS. REV., Sept.–Oct. 2019 [hereinafter *New Approach*], https://hbr.org/2019/09/a-new-approach-to-contracts [https://perma.cc/VBM4-4PS3].

38. *Id.* ("[M]any have told us that they and their partners are happy with the approach and cite benefits including cost savings, improved profitability, higher levels of service, and a better relationship.").

39. *Innovative Way*, *supra* note 1; Frydlinger et al., *New Approach*, *supra* note 37.

40. *New Approach*, *supra* note 37.

general assertions about legal enforceability and general references to the lawyer's role in supply contracting, *Innovative Way* and the predecessor co-authored *HBR* article do not formally address legal doctrinal or practical applied legal considerations.[41]

IV

OBSERVATIONS ABOUT THE BENEFITS OF FORMAL RELATIONAL CONTRACTING IN UNCERTAIN TIMES AS A MATTER OF LAW AND LAWYERING

U.S. contract law and practice underlie the efficacy of the contract-based solution posited in *Innovative Way*. Among other things, the pandemic has reminded us of the utility of bedrock applied contract law principles in addressing uncertainty's effects on contracts.[42] The crisis and overall uncertainty resulting from the COVID-19 pandemic and related economic and social dislocations (including those resulting from government regulation) have generated litigation relating to failed or delayed contractual performance.[43] The pandemic also catalyzed legislative, regulatory, and administrative action relating to contract enforcement, including the Small Business Administration's interpretation that chapter 11 debtors were ineligible for the federal government's Paycheck Protec-

41. One part of a recently released book written by two of the innovative way co-authors and two others does broadly address legal considerations of formal relational contracts and relational contracting. *See* DAVID FRYDLINGER, KATE VITASEK, JIM BERGMAN & TIM CUMMINS, CONTRACTING IN THE NEW ECONOMY 261–75 (2021). The analysis is rooted in general principles, relying in principal part on the notion of freedom of contract and judicial applications of good faith in contract interpretation and enforcement in the United States, several European nations (Germany, France, and the United Kingdom), and Canada. *Id.* The resulting theoretical argument is that the parties' bargained for relational terms contextualize good faith and guide judicial review in that context. *Id.* at 273–74. The four co-authors conclude from this argument that "the court would be bound to follow the parties' intentions," expressing a high degree of confidence that formal relational contracts "will be enforceable in nearly all jurisdictions across the world." *Id.* at 274.

42. *See* Anne G. Crisp, Joan MacLeod Heminway & Gary Buchanan Martin, *Business Law and Lawyering in the Wake of COVID-19*, 22 TRANSACTIONS: TENN. J. BUS. L. 365, 370–73.

> The search for and interpretation of interpretation of *force majeure* clauses consumed the time and practice of business lawyers starting in the spring of 2020. The absence of *force majeure* clauses (or their deficiency in specific circumstances) forced those practicing business law to review and enhance their expertise in the common law contract doctrines of impossibility, impracticability, and frustration of purpose. In mergers and acquisitions and other corporate finance practice, material adverse change and material adverse effect clauses have received attention for similar reasons.

Id. at 370–71.

43. *See, e.g.*, Jonathan C. Lipson & Norman M. Powell, *Contracting COVID: Private Order and Public Good*, 76 BUS. LAW. 437, 448–50 (2021) (noting and describing common types of claims); Xuan-Thao Nguyen, *Contract as Emergency Law*, 30 WASH. INT'L L.J. 420, 437 (2021) ("Overall, the COVID-19 pandemic rendered parties unable to fulfill contracts. Lawsuits related to nonperformance, suspension, breach, and damages in connection with COVID-19 are now entering court dockets across the United States."); *id.* at 450–53, 457–59, 461–62 (noting and describing cases); Dennis J. Wall, Peter J. Biging, Niall A. Paul, Victoria L. Creta & Amy C. Gross, *Recent Developments in Business Litigation*, 56 TORT TRIAL & INS. PRAC. L.J. 279, 295–302 (2021) (noting and describing cases).

tion Program loans and the Centers for Disease Control and Prevention's residential eviction moratorium.[44] Lawyers had roles in those activities. Lawyers were also involved in drafting supply contracts (or advising clients against entering into them) and providing legal counsel on extracontractual solutions to performance interruptions.

The omission of contract law and legal practice references and considerations in *Innovative Way* directly motivates this article and the ideas forwarded in this part. Those omissions are entirely predictable and understandable given the nature of the journal in which *Innovative Way* was published (a business journal) and the backgrounds the co-authors (none of whom practices U.S. law). Yet, these oversights are glaring in the face of legal commentary and experience in the pandemic and other similar environments of uncertainty. These settings create the opportunity to reassess the role of contract law and contracts in problem solving, evaluate and innovate legal doctrine, and better understand and value skilled, creative lawyering. Each of these opportunities shed some light on the recommended use of formal relational contracts in *Innovative Way*.

A. Necessity?

Before offering reflections on several pointed doctrinal and practical legal aspects of the formal relational contract solution posited in *Innovative Way*, it seems fair to step back and note that, apropos of lawyers' many roles in addressing existing contracts during the pandemic and in other times of crisis or change, relationships may matter, regardless of the contents of specific contracts. A common circumstance encountered during the pandemic nicely illustrates the importance of this observation.

Many contracts for goods or services include *force majeure* clauses—contractual provisions that excuse performance in the event of catastrophic events or circumstances. These clauses can be drafted in markedly different ways depending on the risk analysis and risk tolerance of the contracting parties. Some may mention disease, pestilence, or epidemics—or even pandemics or related circumstances; many do not (or did not).

After the onset of the pandemic and in the course of the ongoing appreciation of its many aftershocks, lawyers found themselves advising clients on the applicability of their *force majeure* provisions. If the clause was absent or narrowly tailored to specific cases inapplicable to the COVID-19 pandemic, parties and their legal counsel were looking to the common law contract performance excuses of

44. Business Loan Program Temporary Changes; Paycheck Protection Program, 85 Fed. Reg. 23, 450 (Apr. 28, 2020); *Eviction Protection Declaration*, CTRS. FOR DISEASE CONTROL & PREVENTION (Apr. 1, 2021), https://stacks.cdc.gov/view/cdc/106827 [https://perma.cc/DXG6-R5SX]; *see, e.g.*, Lipson & Powell, *supra* note 42, at 439–40, 453–54 (noting and commenting on the chapter 11 exclusion); Sharon Yamen, Hilary Silvia & Linda Christiansen, *In Defense of the Landlord: A New Understanding of the Property Owner*, 50 URB. LAW. 273, 282 (2021) ("The CDC imposed the drastic eviction moratorium in the face of the looming housing crisis induced by COVID-19 after many called upon the government to impose and extend eviction moratoriums.").

impossibility, impracticability, and frustration of purpose for relief from performance obligations. Some of this contract law analysis and advice has resulted in, or has been important in defending, breach of contract claims in court. Undoubtedly, however, a significant amount of that advice has resulted in renegotiations of contract terms, waivers of nonperformance, consensual no-fault terminations, and other off-contract settlements of what might otherwise have been litigable disputes.[45]

Why is this fact important? Among other things, it raises a question about whether it is the nature of the *contract*—for example, whether it is discrete versus relational—or the nature of the *relations* between parties to a contract that catalyzes or deters shading or fuels the propensity of contracting parties to resort to judicial enforcement or hardball contract terminations that may result in judicial review. The use of formal relational contracts to generate healthy, functional, trusting relations between or among transactional partners is appealingly rational and has had support in the academic literature for many years.[46] While the commentary does not refer specifically to the utility of relational contracting in uncertain times, one can easily appreciate that building reciprocal trust and cooperation is highly useful in a context that otherwise might promote shading or other opportunism.

Acknowledgement of the value of relational contracting, however, does not constitute agreement that relational contracting is necessary—or even advisable—for all. For example, one could predict that relational supply contracts among repeat players in reputational markets may be less important because the parties' behavioral norms will be guided by the maintenance of a positive—even

45. *Cf., e.g.*, Lipson & Powell, *supra* note 42, at 454 ("An important and under-appreciated solution to commercial challenges created by COVID would . . . be the Standstill/Forbearance Agreement."); Cosmos Nike Nwedu, *The Rise of Force Majeure Amid the Coronavirus Pandemic: Legitimacy and Implications for Energy Laws and Contracts*, 61 NAT. RESOURCES J. 1, 17 (2021) ("The energy sector post-COVID-19 will be prone to large-scale arbitrations with less litigations, but contract reopening and renegotiations in good faith can bring a prospect for parties to avert such legal face-off, knowing that it can also trigger disputes if unilateral.").

46. Kent Greenfield, *Using Behavioral Economics to Show the Power and Efficiency of Corporate Law as Regulatory Tool*, 35 U.C. DAVIS L. REV. 581, 625 (2002) ("Some research has shown that the presence of highly complete contracts in a business relationship 'crowds out' trust and cooperation, which leaves both parties worse off."). Research indicates that relational contracts may both emanate from actual or anticipatory trust (also framed by economists as positive reciprocity) and generate trust. *See, e.g.*, Robert C. Bird & Vivek Soundararajan, *From Suspicion to Sustainability in Global Supply Chains*, 7 TEX. A&M L. REV. 383, 407 (2020) ("Relational contracts encourage relation-specific investments. Each side has the trust and capacity to make these investments, which counters the tendency in spot market contracting to suppress relation-specific investments to inefficiently low levels. Such investments in human and site-specific assets also build trust and increase supplier responsiveness." (footnotes omitted)); Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSPECT. 159, 178 (2000) ("The endogenous formation of incomplete contracts through reciprocal choices shows that reciprocity may not only cause substantial changes in the functioning of given economic institutions but that it also may have a powerful impact on the selection and formation of institutions.").

exemplary—standing in the market.[47] Personal relationships among those with contract performance obligations also may impact compliance and dispute resolution, even in the absence of relational contract provisions.[48] Moreover, the coauthors of *Innovative Way* previously acknowledged that formal relational contracting may not be suitable for some supply contract situations, calling out specifically contracts relating to "the purchase of commodity products and services."[49]

Thus, while the enthusiasm for formal relational contracting expressed in *Innovative Way* is both logically attractive in the pandemic era (because it offers agreed-upon—and perhaps tested—ways of settling performance lapses and other differences without resort to judicial enforcement and is grounded in the academic literature), it may not be necessary to the construction and maintenance of an efficient, balanced, productive contractual relationship in times of struggle.

> Relational contracts offer some clear advantages over discretely defined ones, and rushing to the courts over every minor breach of contract is surely unwise and inefficient. Nothing about the law itself compels parties to take such action, though: the existence of legal constraints does not compel the parties to use them.[50]

Although *Innovative Way* argues for the drafting of formal relational supply contracts as a means of creating and sustaining a consistent alignment of the contracting parties' expectations, the expectations of contracting parties may be established and maintained contractually or extra-contractually. Either way, litigation may be deterred.[51] As a result, the overall concern in addressing supply contract relationships in uncertain times may be more a matter of supply chain management than contract design.

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47. *See* Bernstein, *supra* note 22, at 299 ("[W]hen a transaction is embedded in a network, the hostage value of reputation is much greater than when a transaction is between two firms with few, if any, connections to other firms in the relevant market. It is through its effects on the flow of information that structural social capital can function as a network-based contract governance mechanism." (citation omitted)).

48. *See* Macaulay, *supra* note 17, at 63 ("At all levels of the two business units personal relationships across the boundaries of the two organizations exert pressures for conformity to expectations.").

49. *New Approach*, *supra* note 37 ("Before jumping into a formal relational contract process, companies must determine whether it is right for them. Some relationships, such as those involving the purchase of commodity products and services, are truly transactional and only need traditional contracts. But many organizations require long-term, complex relationships for which the vested methodology is well suited").

50. Frank B. Cross, *Law and Trust*, 93 GEO. L.J. 1457, 1487 (2005).

51. This assessment assumes that enforcement through litigation could and would be pursued, which may not be the case in supply chain contracting. *See* Jonathan C. Lipson, *Promising Justice: Contract (As) Social Responsibility*, 2019 WIS. L. REV. 1109, 1139 (2019) ("In many cases, a promisee . . . will have little real exposure for misconduct through the supply chain because there is no contractual privity or other legally-recognized connection between the defendant and the victims.").

B. Enforceability

As noted over time, the legal landscape relating to the enforcement of relational contracts[52] has been both "interventionist" and "reticent."[53] This article does not take on an analysis of the vast body of decisional law and secondary material relating to the enforcement of relational contracts. Instead, the article focuses in on certain doctrinal issues surrounding the formal relational contracts promoted in *Innovative Way*.

Specifically, *Innovative Way* quotes from two provisions included in an exemplar formal relational contract. The first articulates the parties' "shared vision": "'Together, we are a team that celebrates and advances excellence in care for our patients and ourselves through shared responsibility, collaborative innovation, mutual understanding, and the courage to act in a safe and supportive environment.'"[54] The second expresses an obligation to act equitably: "'We are committed to fairness, which does not always mean equality. We will make decisions based on a balanced assessment of needs, risks, and resources.'"[55]

The co-authors of *Innovative Way* indicate that these written commitments are legally enforceable. This claim invites scrutiny.[56] This article offers one line of inquiry that relates most specifically to the second quoted passage and, in particular, the embedded commitment to fairness.

Supply contracts like those referenced in *Innovative Way*, as commercial contracts, include an implied covenant of good faith and fair dealing.[57] Through this covenant, contracting parties may enforce an unexpressed substantive obligation

52. In oral feedback on a draft of this article, commentors made two points about legal enforcement in this context that I want to acknowledge and endorse here. The first is that extra-legal enforcement may be more important than legal enforcement. The second is that legal enforcement can take many forms, from whether legal counsel is confident in offering a legal opinion to whether a legal action will survive a motion to dismiss or for summary judgment or make its way to a finder of fact. In the interest of brevity, this article does not take on each of these important aspects of enforceability.

53. Schwartz, *supra* note 10, at 272 ("The puzzle is why courts are sometimes active and sometimes not.").

54. *Innovative Way*, *supra* note 1.

55. *Id.*

56. The co-authors' claim of enforceability is of obvious interest to the legal community. However, the enforcement of contracts at a time of crisis or other uncertainty may be unpredictable or somewhat predictably uneven or uncertain. *See* David A. Hoffman & Cathy Hwang, *The Social Cost of Contract*, 121 COLUM. L. REV. 979, 997 (2021) (asserting, with reference to the effects of the COVID-19 pandemic, "that courts, standing in for the public, have a chance to reform contracts when the public's burden changes materially and unexpectedly. Courts can reform contracts by excusing performance, interpreting broad carve-outs, and changing contractual burdens to discourage performance."). Also, it should be noted that even unenforceable relational terms may have expressive meaning and value. Accordingly, enforcement may not be the sole coin of the realm.

57. *See, e.g.*, Geler v. Nat'l Westminster Bank USA, 770 F. Supp. 210, 215 (S.D.N.Y. 1991) ("In general, under New York law, a duty of good faith and fair dealing is implicit in every contract, but breach of that duty is merely a breach of the underlying contract.").

to enable achievement of the overall benefit of their expressed contractual bargain.[58] Is building an express obligation of fairness (or, perhaps, best efforts[59]) into a contract as a means of formal relational contracting redundant with the implied covenant of good faith and fair dealing? If not, how do the two relate, from an enforcement perspective?

Either type of fairness covenant, express or implied, could generate an action under contract law if breached.[60] However, a court may apply a canon of superfluity if it deems two or more claims for breach to be entirely or substantially overlapping.[61] "While a plaintiff may bring claims for both breach of contract and breach of the implied covenant, when both claims rely on the same alleged acts and seek the same relief, the Court may disregard the breach of the implied covenant claim as superfluous."[62] A court may then, in its discretion, effectively nullify the implied covenant of good faith and fair dealing but still enforce an express

58. *See, e.g.*, Shaulis v. Nordstrom Inc., 120 F. Supp. 3d 40, 55 (D. Mass. 2015), *aff'd*, 865 F.3d 1 (1st Cir. 2017) ("The implied covenant may not be invoked to create rights and duties not contemplated by the provisions of the contract or the contractual relationship."); Waller v. Truck Ins. Exch., Inc., 900 P.2d 619, 639 (1995) ("In sum, the covenant is implied as a supplement to the express contractual covenants, to prevent a contracting party from engaging in conduct that frustrates the other party's rights to the benefits of the agreement.").

59. *See* Bloor v. Falstaff Brewing Corp., 601 F.2d 609, 610 (2d Cir. 1979) (adjudicating a "best efforts" clause in the context of an earnout provision); *see also* Victor P. Goldberg, *In Search of Best Efforts: Reinterpreting* Bloor v. Falstaff, 44 ST. LOUIS UNIV. L.J. 1465, 1483 (2000) ("Ballantine's lawyers asked various witnesses what best efforts meant to them and whether it meant more than good faith . . . ."). A claim for breach of the implied covenant of good faith and fair dealing may fail to the extent that a related claim for breach of a best efforts obligation is unsuccessful. *See* Benihana of Tokyo, LLC v. Angelo, Gordon & Co., 259 F. Supp. 3d 16, 37 (S.D.N.Y. 2017), *aff'd*, 712 F. App'x 85 (2d Cir. 2018) (finding that the plaintiff's claim for breach of the implied covenant of good faith and fair dealing "impermissibly duplicates" its companion claim for breach of an express best efforts obligation); Wurtsbaugh v. Banc of Am. Sec. LLC, No. 05 CIV. 6220(DLC), 2006 WL 1683416, at *6 (S.D.N.Y. June 20, 2006) ("Having failed to state a viable claim for breach of the Best Efforts Clause, the plaintiffs may not manufacture a breach through invoking the duty of good faith and fair dealing.").

60. Although good faith and fair dealing claims may most often be raised as a defense in litigation, they also constitute affirmative claims brought in complaints, including in supply contracts. *See, e.g.*, J-M Mfg. Co. v. Affiliated FM Ins. Co., No. 2:19-cv-05550-JWH-SKx, 2021 WL 4891826, at *1 (C.D. Cal. July 6, 2021) ("JM Eagle alleges three causes of action for breach of contract, tortious breach of the implied covenant of good faith and fair dealing, and declaratory relief . . . ." (footnote omitted)); Mirion Techs. (Canberra), Inc. v. Sunpower, Inc., No. 2:17-CV-669, 2017 WL 5090436, at *5 (S.D. Ohio Nov. 6, 2017) ("Mirion asserts three claims, all based on Sunpower's refusal to fill the purchase order: (1) breach of the Supply Agreement, (2) anticipatory repudiation of the Agreement, and (3) breach of the duty of good faith and fair dealing."); Hitchiner Mfg. Co. v. Eaton Corp. Plc., No. 15-cv-153-PB, 2015 WL 8492044, at *1 (D.N.H. Dec. 10, 2015) (raising claims under a supply agreement "for common law breach of contract, unjust enrichment, breach of contract under the Uniform Commercial Code . . . and breach of the duty of good faith and fair dealing"); Koch Materials Co. v. Shore Slurry Seal, Inc., 208 F.R.D. 109, 111 (D.N.J. 2002) ("Koch filed a complaint against Shore Slurry containing three counts: (1) breach of an Exclusive Supply Agreement; (2) breach of the Novachip Sublicense Agreement; and (3) breach of implied covenant of good faith and fair dealing.").

61. *See, e.g.*, Careau & Co. v. Sec. Pac. Bus. Credit, Inc., 272 Cal. Rptr. 387, 399 (Ct. App. 1990) ("If the allegations do not go beyond the statement of a mere contract breach and, relying on the same alleged acts, simply seek the same damages or other relief already claimed in a companion contract cause of action, they may be disregarded as superfluous as no additional claim is actually stated.").

62. Daniels v. Alphabet Inc., No. 20-cv-04687-VKD, 2021 WL 1222166, at *9 (N.D. Cal. Mar. 31,

contractual fairness commitment. A party seeking enforcement of both the express and implied terms will want to proceed in structuring its case with the doctrine of superfluity in mind to best ensure that its claims are made in a manner that preserves the applicability of the implied covenant of good faith and fair dealing, as desired. Moreover, contract drafters should recognize the possible future invocation of superfluity in the words they choose to expressly convey fairness obligations in their written agreements. Finally, lawyers reviewing proposed or actual contracts for the purpose of offering compliance or other legal advice relating to business operations will want to take the possibility of superfluity into account in their work.

Absent superfluity, the implied covenant of good faith and fair dealing may operate independently to reinforce—and hold contracting parties more strictly accountable for—compliance with notions of fairness explicitly articulated by those parties as express underpinnings of their transactional relationship.

> [A]llegations which assert such a claim must show that the conduct of the defendant . . . demonstrates a failure or refusal to discharge contractual responsibilities, prompted not by an honest mistake, bad judgment or negligence but rather by a conscious and deliberate act, which unfairly frustrates the agreed common purposes and disappoints the reasonable expectations of the other party thereby depriving that party of the benefits of the agreement. Just what conduct will meet these criteria must be determined on a case by case basis and will depend on the contractual purposes and reasonably justified expectations of the parties.[63]

A claim for breach of both an express and implied fairness obligation may be useful when a party to a contract facially complies with express contractual provisions in a manner that is inconsistent with the spirit underlying the parties' agreement.

One could imagine a facial compliance claim of this kind in the context of the above-quoted exemplar provisions from *Innovative Way*. A contracting party could, for instance, produce evidence of its engagement in "shared responsibility, collaborative innovation, mutual understanding, and the courage to act in a safe and supportive environment"[64] or its participation in "a balanced assessment of needs, risks, and resources"[65] (in each case, core elements of the terms quoted in *Innovative Way*, as noted above) in support of an argument that it complied with its equity obligation and fairness commitment. Yet, the party could have achieved that compliance in a "check the box" manner inconsistent with the overall contract terms including the exemplar contract's acknowledgement of a shared vision.[66] It is unclear whether the *Innovative Way* co-authors have considered this

2021); *see also Benihana*, 259 F. Supp. 3d at 37 ("[W]hen a plaintiff claims a breach of the implied covenant of good faith and fair dealing based on the same facts as a breach of contract claim and seeking identical damages for the breach, the claim for the breach of the covenant of good faith and fair dealing must be dismissed as duplicative of the breach of contract claim.").

63. *Careau*, 272 Cal. Rptr. at 399–400.

64. *See supra* note 54 and accompanying text.

65. *See supra* note 55 and accompanying text.

66. *See* David V. Snyder, *Contracting for Process*, 85 LAW & CONTEMP. PROBS., no. 2, 2022, at 255, 262 (2022) ("[R]elational contracts . . . have enforcement problems. There is not much that courts can do with them, given the vagueness of the terms and the doubtful verifiability of the necessary information.

possibility or specifically engaged in the analysis of other potential enforcement issues, for that matter. Although relationship-oriented provisions like those described and quoted in *Innovative Way* should help courts in interpreting the nature and extent of the contracting parties' obligations,[67] shirking may still occur. Accordingly, the possibility that the enforcement of an express fairness covenant may be strengthened by continued reliance on the implied covenant of good faith and fair dealing should be of concern to litigators, contract drafters, and legal counsel providing compliance and other operational advice.

C. Lawyering

Necessity and enforcement questions arising from formal relational contracting are sure to keep lawyers thinking. Litigators, for example, may compare relational and discrete contracts in a variety of dispute resolution contexts—wondering, for example, whether contracting parties are more likely to bring claims based on relational contract terms given their inherent incompleteness or whether it is more difficult and time-consuming for courts to adjudicate relational contract terms. Lawyers who draft supply contracts, for example, will cogitate over the precise terms to be used to most clearly express relational matters and the contexts in which the provisions addressing those matters are applicable. In-house counsel who provide general legal advice to business management may question the need for or efficiency of formal relational contracting in light of the nature of their supply contracts or their supply chain partners. Yet, necessity and enforcement are but a few of the many relational contract issues that present advisory opportunities for legal counsel.

For litigators, assuming causes of action for enforcement are available, remedies issues may loom large. In the absence of a valid, binding, and enforceable liquidated damages clause or other tailored remedies provisions, trial lawyers evaluating possible breach of contract claims of their supply chain clients may, for example, have questions about the scope of available remedies.[68] More specifically, breaches of fairness and qualified efforts obligations, including those committing a party to use its best efforts or commercially reasonable efforts, may raise questions about the availability of tort remedies.[69] These contractual obligations establish behavioral norms that may not exclusively or directly generate

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Plus, courts are reluctant to intervene in highly relational contracts.").

67. *See id.* at 266 (noting that parties to relational contracts "through their experience with each other, can state their processes for decision-making, production, marketing, and the like" and that "[m]ore highly specified processes will make enforcement easier, less costly, and more certain than under an unadorned efforts clause.").

68. *See* Macneil, *supra* note 5, at 789–90 ("[D]iffuse relational obligation, even in the face of serious trouble, often remains unspecific in terms of ultimate sanction, although processes (as distinct from substantive remedies) for continuing relations in spite of trouble may be quite specific in nature.").

69. *See* Richard J. Kohlman & Robert E. Cartwright, *Bad Faith Tort Remedy for Breach of Contract*, 34 AM. JUR. TRIALS 343, § 20 (2021) ("It would appear that a cause of action for a 'tortious' breach of a commercial contract exists whenever the defendant in *bad faith* denies the existence of the underlying contract, commits acts tantamount to such a denial, or seeks to enrich himself beyond what he is entitled to by unjustified threats of legal action."); Robert A. Hillman, *The Future of Fault in Contract Law*, 52

economic loss under the contract. As such, economic loss damages may not make an aggrieved party whole. Specific performance and injunctive relief also may be inadequate. As a result, while rarely available in fact, the possibility of tort remedies may be attractive to a contracting party that believes it has been wronged, including because of the leverage those remedies may provide in extrajudicial settlements of the parties' contractual affairs.

Might tort remedies be available for a breach of relational contracts? Although disfavored,[70] arguments for awarding tort remedies for contract breaches had some traction in the literature in the 1980s,[71] and may seem logical and equitable in a relational contract setting. Torts are harms to person or property, and relational contract claims of unfair conduct or of the failure to comply with efforts commitments bear close resemblance to or may be duplicative of tort claims. Tort remedies may, in fact, be available if a contract creates a fiduciary relationship[72] or if a promisor fraudulently misrepresents an intention.[73] Yet, it seems unlikely that tort remedies would be awarded for most breaches of a formal relational supply contract.

Courts that have awarded tort remedies for contract breaches have required proof of specific facts warranting them—for example, fiduciary or fiduciary-like relations or unique power imbalances making one party vulnerable to the other.[74]

DUQ. L. REV. 275, 289 (2014) ("[C]ourts have recognized an 'independent tort' in the contract context including where a party misrepresents facts during negotiations or recklessly performs a contract.").

70. *See generally* RESTATEMENT (THIRD) OF TORTS § 3 (AM. L. INST. 2020) [hereinafter RESTATEMENT] ("Except as provided elsewhere in this Restatement, there is no liability in tort for economic loss caused by negligence in the performance or negotiation of a contract between the parties.").

71. *See, e.g.*, Thomas A. Diamond, *The Tort of Bad Faith Breach of Contract: When, If At All, Should It Be Extended Beyond Insurance Transactions*, 64 MARQ . L. REV . 425 (1981) (arguing for limits on tort remedies for breaches of the implied covenant of good faith and fair dealing); Richard E. Speidel, *The Borderland of Contract*, 10 N. KY. L. REV. 163 (1983) (exploring the boundaries of tort and contract law relating to, among other things, available remedies); Murray Tabb, *Employee Innocence and the Privileges of Power: Reappraisal of Implied Contract Rights*, 52 MO. L. REV. 803, 859–64 (1987) (discussing breaches of the implied covenant of good faith and fair dealing under contract and tort law principles, citing to related decisional law).

72. *See* RESTATEMENT, *supra* note 70, § 16 ("An actor who breaches a fiduciary duty is subject to liability to the person to whom the duty was owed."). The comments to § 16 clarify that the fiduciary relationship may stem "from the terms of a contract or from less formal dealings that create the elements of such a relationship. Those elements generally consist of trust and reliance on the fiduciary by another." *Id.* cmt. a. The possibility exists, for example, that a relational contract may inadvertently create a partnership—which is a fiduciary relationship—between the contracting parties. *See* Christine Hurt, *Startup Partnerships*, 61 B.C. L. Rev. 2487, 2491 (2020) ("The default partnership is not just a theory or an occasional rarity in everyday life; it continues to rear its head in cases involving both inexperienced contract parties and the most sophisticated business players.").

73. RESTATEMENT, *supra* note 70, § 9 ("One who fraudulently makes a material misrepresentation of . . . intention . . . for the purpose of inducing another to act or refrain from acting, is subject to liability for economic loss caused by the other's justifiable reliance on the misrepresentation.").

74. *See* Mitsui Mfgs. Bank v. Superior Ct., 260 Cal. Rptr. 793, 795–96 (Ct. App. 1989) ("[T]he ability to recover tort damages in breach of contract situations [is limited] to those where the respective positions of the contracting parties have the fiduciary characteristics of that relationship between the insurer and insured"); Wallis v. Superior Ct., 207 Cal. Rptr. 123, 129 (Ct. App. 1984) (noting, among other predicates for tort liability, that "the contract must be such that the parties are in inherently unequal bargaining

Commercial supply relationships do not typically exhibit these attributes. Thus, in the absence of enforceable liquidated damages provisions or other enforceable stipulated remedies, lawyers litigating cases involving breaches of relational contract provisions like those advocated in *Innovative Way* may find it difficult to frame a case to provide a suitable remedy (including, for example, punitive damages) for the asserted breach. Lawyers charged with drafting formal relational contracts may therefore want to consider the advantage of expressly providing for specific remedies, including liquidated damages, for breaches of relational covenants.[75]

Regardless, lawyers focusing on relational contract drafting will also encounter strategic and tactical concerns in providing their services. Macneil recognized that contract design could address relational concerns between or among contracting parties *ex ante* whether through transactional or relational contract provisions.[76] This idea contributed to the development of a vibrant, increasingly rich academic literature on contract design[77] and drafting, featuring contributions from Henry Blair, Iva Bozovic, Ronald Gilson, Gillian Hadfield, Cathy Hwang, Matthew Jennejohn, Charles Sabel, Robert Scott, George Triantis, and Kate Vitasek, among others.[78]

This literature has resulted in the identification and definition of various contract designs and design elements relevant to formal relational contracting.

positions" and "one party is especially vulnerable because of the type of harm it may suffer and of necessity places trust in the other party to perform").

75. *See* Snyder, *supra* note 66, at 258 (describing the importance of remedies in rendering contracts reliable and the broad scope of modern contract remedies).

76. *See* Macneil, *supra* note 5, at 805 (noting that efforts may be made in advance to address relational concerns); *see also id.* at 810 (noting the genesis of and need for planning in contract transactions and relations).

77. One commentator on a draft of this article noted that "relationship design" or "supply chain design" may be more targeted descriptors of the most salient aspects of contract design. His essential point? It is the structure of the relationship, rather than the structure of the contract, that truly matters in disputes between the contracting parties.

78. Published articles written by these authors alone are too numerous to cite here, except by representative example (with apologies to the authors for works left off the subsequent citation list). Henry Allen Blair, *Anticipating Procedural Innovation: How and When Parties Calibrate Procedure Through Contract*, 72 OKLA. L. REV. 797 (2020); H. Allen Blair, *Promise and Peril: Doctrinally Permissible Options for Calibrating Procedure Through Contract*, 95 NEB. L. REV. 787 (2017); Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984); *Braiding*, *supra* note 11; Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Terms*, 88 N.Y.U. L. REV. 170 (2013); Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009); Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23 (2014); Cathy Hwang, *Value Creation by Transactional Associates*, 88 FORDHAM L. REV. 1649 (2020); Gillian K. Hadfield & Iva Bozovic, *Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation*, 2016 WIS. L. REV. 981; Cathy Hwang, *Unbundled Bargains: Multi-Agreement Dealmaking in Complex Mergers and Acquisitions*, 164 U. PA. L. REV. 1403 (2016); Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NW. U. L. REV. 279 (2018); Jennejohn, *supra* note 11; Matthew Jennejohn, *The Private Order of Innovation Networks*, 68 STAN. L. REV. 281 (2016); Scott, *supra* note 22; Scott, *supra* note 30; Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RES. L. REV. 187 (2005); Vitasek et al., *supra* note 30.

Braiding and Vested, noted *supra* Parts II and III, respectively, are two examples.[79] Scaffolding, "the use of *formal contracting*—meaning reliance on formal legal rules, norms, practices and expertise—without the use of *formal contract enforcement*," is yet another.[80] The contextual use of these and other contract design methods and rubrics should inform the work of contract drafters. Yet, legal counsel engaged in contract drafting may not be aware of or familiar with this academic literature. As a result, the influence of the academic literature on contract drafting practice is unclear, and the optimal use of one design approach or another in individual contract drafting contexts is underexamined.

Nevertheless, the academic literature does reflect and describe certain common contracting practices. At the heart of the contract drafter's task is the recognition, evaluation, and effective management of risk, including the risk of shirking, shading, and litigation. Risk is impacted by the trust between and among contracting parties.[81] Formal relational contracting generates trust through the parties' negotiation of and commitment to the agreed terms of the contract.[82]

> [P]arties today often treat trust as endogenous, as an object of contracting rather than as a precondition. They write contracts in which they manifestly intend to establish a deeply collaborative relation, where little or none existed before, through a combination of formal and informal elements. Rather than writing high-powered formal contracts that tie incentives to outcome variables, these parties write formal contracts to motivate low powered incentives to collaborate.[83]

As a result, a feedback loop is possible between contract design theory and contract drafting practice. Contract design theory should inform contract drafting practice in the same way that contract drafting practice informs contract design theory. This observation provides an impetus for better ongoing communication between contract design theorists and legal drafting practitioners.

Contract compliance and advisory counsel will have their own sets of questions about formal relational contracting. For example, in-house and other lawyers providing general business law advice to their clients may have questions about the cost of formal relational contracting. Even those business professionals and advisers who favor its use in appropriate contexts acknowledge the up-front costs associated with the negotiation, construction, and execution of formal relational contracts.

> Negotiations to create a formal relational contract are not "positional" but require full disclosure on both sides before the hard work begins of building a governance framework both parties agree is fair. Because it may take weeks or months of negotiations before the parties can even achieve full disclosure, not to mention weeks or months to hammer out the details of a governance framework which both parties sincerely believe is fair, it may take between six and twelve months for the parties to produce a "formal

79. *See* sources cited *supra* note 11 and accompanying text (relating to braided contracts); *supra* note 38 and accompanying text (mentioning Vested contracts).

80. Hadfield & Bozovic, *supra* note 78, at 1007.

81. *See* Russell Korobkin, *The Borat Problem in Negotiation: Fraud, Assent, and the Behavioral Law and Economics of Standard Form Contracts*, 101 CAL. L. REV. 51, 85–86 (2013) ("[T]rust reduces both the risks of being exploited and the costs of monitoring one's contracting partners.").

82. *See supra* note 46 and accompanying text.

83. *Braiding*, *supra* note 11, at 1404–05.

> relational contract" for a large-scale, long-term outsourcing agreement that is legally enforceable.[84]

The efficacy of this relatively high level of *ex ante* investment in formal relational contracting is likely to be case-specific but will depend generally on the achievement of a favorable tradeoff between two principal efficiency objectives: efficiency in creating and maintaining the contractual relations between the parties and efficiency in producing the desired contract terms.[85] "Because these goals are in tension, and because contracting occurs in markets with particular characteristics, parties inevitably trade off one objective against the other in very different ways."[86] The assessment of relative efficiencies is not likely to be simple or straightforward. But a lawyer's knowledge of the markets in which the client operates will facilitate an informed appraisal.

V

CONCLUSION

Innovative Way offers contracting parties and their legal counsel appealing, generalized contract design advice grounded in relational contract theory originating in academic literature from economic, legal, sociological, and business management traditions. Specifically, the co-authors of *Innovative Way* promote the use of formal relational contracts as a means of limiting or eliminating opportunistic behaviors that are likely to occur in times of crisis or other uncertainty. This article inspects the co-authors' thesis from the perspective of U.S law and lawyering—angles not expressly addressed in *Innovative Way*.

The article's brief review of the claims made in *Innovative Way* yields several germane observations. Among other things, that review includes reflections on the necessity of a contract solution to the undesired opportunistic behavior identified in *Innovative Way*, the enforceability of formal relational contract terms, and the effects of formal relational contracting on the contract-related services routinely provided by legal counsel. Overall, the preliminary assessment offered in this article does not provide conclusive or convincing evidence of the validity or invalidity of the articulated benefits of formal relational supply chain contracting.

Formal relational contracting deserves more study. Theoretical work can be expanded and refined to support more complete descriptions of formal relational contract types, designs, and elements and promote accurate predictions of the precise circumstances in which formal relational contracting can be both beneficial and efficient. Empirical work like that conducted by Stewart Macaulay,[87]

84. Vitasek et al., *supra* note 30, at 129.

85. *See* Scott, *supra* note 22, at 98 (noting these two objectives).

86. *Id.*

87. Macaulay, *supra* note 17.

Alan Schwartz,[88] David Hoffman,[89] Gillian K. Hadfield and Iva Bozovic,[90] and others could help isolate circumstances in which formal relational contracts may be needed and are most likely to be enforced. Empirical studies also may provide information useful to lawyers working in the dispute resolution, drafting, and business advisory aspects of contract law relevant to formal relational contracting, including by adding knowledge relevant to available remedies and effective and efficient contract designs and provisions.[91] With this information, contracting parties and their lawyers can make better informed judgments about whether and when to engage in formal relational contracting to forestall shading and other opportunistic behaviors that may be expected in uncertain times.

88. Schwartz, *supra* note 10.

89. David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. 389 (2014).

90. Hadfield & Bozovic, *supra* note 78.

91. *See, e.g.*, Matthew Jennejohn, *The Transactional Dynamics of Market Fragility*, 85 LAW & CONTEMP. PROBS., no. 2, 2022, at 281 (examining the effects and policy implications of parties' choices of a relational contract compared to an arm's length arrangement and choice of contract partners); *see also, e.g.*, Uri Benoliel, *The Interpretation of Commercial Contracts: An Empirical Study*, 69 ALA. L. REV. 469, 469 (2017) (studying the incidence of merger clauses in commercial contracts); Matthew Jennejohn, Julian Nyarko & Eric L. Talley, *COVID-19 as a Force Majeure in Corporate Transactions* (Colum. L. & Econ., Working Paper No. 625, 2020), https://scholarship.law.columbia.edu/faculty_scholarship/2645 [https://perma.cc/7WGK-WFXP] (reporting on a study of the use of pandemic-related provisions in public company material adverse effect clauses); Ilias Vlachos, *Contract Design and Supplier Performance: An Empirical Investigation Using Multi-Criteria, Decision Analysis*, 70 INT'L J. PROD. & PERF. MGMT. 1655 (2021) (studying the relationship between contract design and supplier performance). Two academic co-authors note that "interest in the empirical study of contracts was inspired, in part, by relational contract theory. By rejecting the image of contracts as complete embodiments of an agreement, relational contract theory made the form and structure of contracts interesting." D. Gordon Smith & Brayden G. King, *Contracts As Organizations*, 51 ARIZ. L. REV. 1, 5 (2009).