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Henry Allen Blair

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ANTICIPATING PROCEDURAL INNOVATION: HOW AND WHEN PARTIES CALIBRATE PROCEDURE THROUGH CONTRACT

HENRY ALLEN BLAIR*

Abstract

Despite a vast literature on contract theory, scholars are only just scratching the surface of understanding how parties design their contracts in the real world. This shortfall is particularly true of procedural customizations. Contrary to some early commentators' estimates, in a small but significant set of circumstances, parties engage in a diverse range of procedural customization. To date, however, scholars have struggled to identify and explain the patterns of ex ante procedural contracting.

This Article argues that the first step toward understanding how transactional attorneys harness the potential of procedural autonomy is to recognize that procedural customization functions most effectively to offset litigation opportunism. By systematically considering how various forms of customization limit or eliminate litigation opportunism, this Article demonstrates how contract design can be improved through procedural contracting. This Article then advances a typology of procedural innovation that considers the key attributes underlying a transaction, namely the degree of environmental and behavioral uncertainty present and the frequency with which other similar parties contract in the same domain. This typology offers tentative predictions about when and how parties are most likely to calibrate procedure through contract.

* Robins Kaplan Distinguished Professor of Law, John H. Faricy Professor of Empirical Research, and Senior Fellow, Dispute Resolution Institute, Mitchell Hamline School of Law. I would like to thank Robert E. Scott, Victor Goldberg, and the faculty, staff, and students at Columbia University School of Law for their excellent comments and feedback on early versions of this Article. I would also like to thank the Center for Law and Economic Studies at Columbia University School of Law and Mitchell Hamline University School of Law for providing financial support in drafting and presenting versions of this paper.

Introduction

*A more complete theory of contract design would anticipate all possible back-end processes and the interaction among them.*¹

Commercial parties are generally free to exercise autonomy by authoring the substantive terms of their contracts.² A growing number of commentators have asked whether similar freedom extends to procedure: can, do, and should parties be allowed to author the processes used to determine their substantive rights?

The implications of customizable procedure are profound.³ The notion that transacting parties can create their own procedural rules governing the

1. Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L.J. 814, 822 (2006) [hereinafter Scott & Triantis, *Anticipating Litigation*].

2. In this article, I focus on contracts between sophisticated parties with relatively equal bargaining power. See, e.g., Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 543–44 (2003) (explaining the problems with considering contract law as applying to “the entire continuum from standard form contracts between firms and consumers to commercial contracts among businesses” and advancing an argument for focus on “business contracts”); Robert E. Scott, *The Law and Economics of Incomplete Contracts*, 2 ANN. REV. L. & SOC. SCI. 279, 281 (2006) (“Contracts involving individual consumers raise separate issues that challenge the assumption that their commitments are voluntary, rational, and informed.”). I do not, however, do this in order to perpetuate a Willistonian, unitary approach to contract law. See HANOCH DAGAN & MICHAEL HELLER, *THE CHOICE THEORY OF CONTRACTS* 8 (2017) (explaining how Samuel Williston “elevated commercial transactions to the core of contract, and, as a byproduct, substantially obscured the generative role of diverse contract types”). To the contrary, as I discuss in greater detail in a separate forthcoming article, *The Line Between Mockery and Efficiency: The Normative Implications of Private Process*, (2020) (on file with author), the most compelling normative objections to private process involve contracts between disparate parties, which involve a differing balance of values. That conclusion compels another: procedural contracts between commercial parties and individuals should be subject to closer scrutiny.

3. By “customizable” procedure, I mean “procedural contracting” or “private procedural ordering,” all terms which encompass mechanisms parties use to control the processes used to resolve disputes. See, e.g., Jaime Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 723, 724–25 (2011) (describing the process of “modifying [by contract] the spectrum of procedure” as private procedural ordering). In previous work, I have used these terms interchangeably and in the broadest possible sense, to include all party agreements about procedure, including but not limited to arbitration, mediation, med-arb, and settlement. See generally Robin J. Effron, *Ousted: The New Dynamics of Privatized Procedure and Judicial Discretion*, 98 B.U. L. REV. 127 (2018) (similarly using the term “private procedural ordering” to refer to both pre- and post-dispute customizations of procedure). Compare Kevin E. Davis & Helen Hershkoff, *Contracting for Procedure*, 53

backend of the contracting process unlocks an additional dimension of design choices.⁴ Contract theory already recognizes many ways that forward-thinking parties, mindful of the possibility of future disagreements, fine-tune their substantive commitments.⁵ By calibrating the completeness of contractual terms, for instance, parties regulate when, and by whom, content will be determined.⁶ Parties use both rules and standards to accomplish this. They may invest resources ex ante, drafting precise obligations, to avoid uncertain results; alternatively, they may draft intentionally vague or open-ended obligations for a court or tribunal to

WM. & MARY L. REV. 507, 511 (2011) (describing contract procedure as “the practice of setting out procedures in contracts to govern disputes . . . that will be adjudicated in the public courts”), with Erin O’Hara O’Connor & Christopher R. Drahozal, *Carve-Outs and Contractual Procedure 2* (Vanderbilt Pub. Law & Legal Theory Research Paper No. 13-29, 2013). In this article, however, I am focusing on ex ante procedural contracting.

4. See, e.g., Gillian K. Hadfield, *Judicial Competence and the Interpretation of Incomplete Contracts*, 23 J. LEGAL STUD. 159, 162 (1994) (recognizing that parties can anticipate and adjust for legal errors in their initial contract); Scott & Triantis, *Anticipating Litigation*, *supra* note 1, at 822 (recognizing the importance of dispute resolution on contract design and “call[ing] for further research into the interaction between contract and litigation, as well as future investigation into the effect of other back-end processes, such as arbitration, renegotiation, and settlement”).

5. See, e.g., Albert Choi & George Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L.J. 848, 852 (2010) (“[D]rawing on the line of scholarship that analyzes the rules-standards dichotomy in the design of legal rules, recent work frames the choice between vague and precise contract terms as a tradeoff in information costs: precise contract provisions raise contracting costs on the front end, but reduce enforcement costs at the back end.”); Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX. L. REV. 1581, 1583–84 (2005) (defining the cost of a contract as the ex ante negotiating and drafting costs, plus the probability of litigation multiplied by the sum of the parties’ litigation costs, the judiciary’s litigation costs, and judicial error costs); Scott & Triantis, *Anticipating Litigation*, *supra* note 1, at 816–18 (noting that investment in ex ante contract design generally reduces ex post contract enforcement costs, and that less investment in ex ante contract design generally increases ex post contract enforcement costs); Schwartz & Scott, *supra* note 2, at 546 (arguing that it “is futile to pursue either distributional goals or contractual fairness” in contracts between firms, as “firms will contract away from redistributive or fair legal rules that do not maximize joint surplus”); Steven Shavell, *On the Writing and the Interpretation of Contracts*, 22 J.L., ECON., & ORG. 289, 290 (2006) (discussing the role of back-end contract interpretation in influencing how parties design contracts ex ante).

6. Scott & Triantis, *Anticipating Litigation*, *supra* note 1, at 818 (“The choice between precise terms and vague terms thus reduces to who chooses [obligations] . . . and when they are chosen: the parties at the time of contracting or the court at trial.”).

interpret *ex post*.⁷ Procedural fine-tuning extends the same logic, giving parties additional governance mechanisms to address exchange hazards.⁸

Despite the benefits, commentators have suggested that lawyers and potential litigants do not consider most of the rules of litigation as defaults.⁹ At least on cursory inspection, empirical evidence seems to confirm this, suggesting that parties conceptualize procedural rules as primarily mandatory or immutable.¹⁰ Parties commonly agree on where to litigate and who should decide any dispute, but it appears that they rarely enter into *ex ante* agreements about how they will litigate—at least not in detail.¹¹ Stated differently, no one doubts that parties make a handful of coarse, modular customizations by selecting bundles of pre-fabricated procedures through forum selection, arbitration, and choice-of-law clauses.¹² Parties may also opt out of other bundles of procedures by waiving rights to a jury trial, appeal, or class action suit.¹³ But most of the existing empirical studies indicate that customization ends there; parties fail to devote significant resources to fine-tuning the processes by which their disputes will be adjudicated before a dispute arises.¹⁴

A closer and holistic examination of the evidence, however, yields a more nuanced picture. First, parties occasionally assign different bundles of

7. See Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1071 (2009) (“[T]he parties are exploiting their informational advantage (they know their contractual ends and have the right incentives to choose the best means to achieve them), but they are sacrificing the hindsight advantage that a court might have.”).

8. I use the term “exchange hazards” in a broad sense to mean the vulnerabilities that firms face when engaging with exchange partners. See, e.g., OLIVER E. WILLIAMSON, *THE MECHANISMS OF GOVERNANCE* 12 (1996).

9. See, e.g., Henry S. Noyes, *If You (Re)build It, They Will Come: Contracts to Remake the Rules of Litigation in Arbitration’s Image*, 30 HARV. J.L. & PUB. POL’Y 579, 612 (2007).

10. See, e.g., David A. Hoffman, *Whither Bespoke Procedure?*, 2014 U. ILL. L. REV. 389, 394 (“[E]ven in circumstances where we would expect them to, parties almost never use contract terms to vary their post-dispute procedural contests.”); Erin O’Hara O’Connor et al., *Customizing Employment Arbitration*, 98 IOWA L. REV. 133, 136–37 (2012) (finding that parties to CEO employment contracts rarely customized arbitration provisions); see *infra* Part II.

11. See *infra* Part II.

12. See *infra* Part II.

13. See *infra* Part II.

14. See H. Allen Blair, *Promise and Peril: Doctrinally Permissible Options for Calibrating Procedure Through Contract*, 95 NEB. L. REV. 787, 813–15 (2017) [hereinafter Blair, *Promise and Peril*] (reviewing the existing empirical studies); see *infra* Part II.

procedures to different claims—choosing, for instance, to arbitrate one category of dispute and litigate another.¹⁵ This claim-by-claim customization, while still modular, may refine contract design more profoundly than many commentators have previously acknowledged. Additionally, when parties opt for arbitration, they sometimes engage in greater procedural adaptation. For example, parties may specify qualifications for an arbitrator, limit the arbitrator’s authority, or authorize the arbitrator to use a standard of decision other than law.¹⁶ Finally, at least occasionally, parties design robust and highly tailored procedural systems that readjust accuracy and efficiency to meet their deal-specific preferences.¹⁷ These procedural systems distribute dispute resolution to different decision makers—some private and some public—at various levels. These systems create feedback loops that function to ratchet up trust and information-sharing while narrowing the domains within which conflict can fester.

In short, knitting together various strands of empirical evidence shows that more intentional and deal-specific procedural customization takes place than previously thought. The challenge then becomes identifying and explaining the patterns of *ex ante* procedural contracting.¹⁸

In this Article, I argue that patterns begin to emerge once we focus on the different risks that parties are trying to mitigate or eliminate in variegated types of transactions. In doing so, I build on work started by Professor Matthew Jennejohn. He has previously argued that “[p]arties not only have to navigate more than one type of transaction cost [or exchange risk], but they must also choose how to combine different types of governance tools into a coherent portfolio—the multivalent contract.”¹⁹ This Article sketches

15. Christopher R. Drahozal & Erin O’Hara O’Connor, *Unbundling Procedure: Carve-Outs from Arbitration Clauses*, 66 FLA. L. REV. 1945, 1956–61 (2014) [hereinafter Drahozal & O’Hara O’Connor, *Unbundling Procedure*] (studying the circumstances in which parties who include arbitration clauses in their contracts carve out certain categories of disputes for resolution in courts); Matthew Jennejohn, *The Private Order of Innovation Networks*, 68 STAN. L. REV. 281, 359–63 (2016) [hereinafter Jennejohn, *The Private Order*] (same).

16. *See infra* Part II.

17. *See infra* Part II.

18. *See, e.g.*, W. Mark C. Weidemaier, *Customized Procedure in Theory and Reality*, 72 WASH. & LEE L. REV. 1865, 1873–75 (2015) (introducing three possible explanations for the gap between theory and practice, concluding that none fare well, and concluding that “[t]he question remains, however, why parties do not embrace customized procedure more fully”); *see infra* Part III.

19. Jennejohn, *The Private Order*, *supra* note 15, at 323.

an initial theoretical framework for thinking about the role procedural customization plays in creating a multivalent contract.

It argues that procedural customization functions most effectively to offset one particular transaction risk: litigation opportunism. It then argues that the desirability of procedural choice turns, in significant part, on key attributes underlying the transaction—namely, the degree of environmental and behavioral uncertainty present and the frequency with which similar parties contract in the same domain. These attributes of the transaction determine the degree of litigation opportunism risk present and, thus, the value of procedural customization in any given circumstance. The core intuition of this Article can be seen as an extension of the logic used in a growing body of contract theory literature, showing that transaction type indicates which interpretation regime should govern the interpretation of a particular contract.²⁰

This Article advances in three parts. Part I begins by recounting the benefits of procedural autonomy. Theory already explains how parties author their substantive obligations with an eye toward the possibility of future disagreements. Part I builds on this premise and demonstrates that procedural customization can provide contract designers with additional tools to address litigation opportunism and incentivize compliance with substantive terms of the deal.

Part II surveys the existing empirical evidence on procedural contracting. Most individual empirical studies conclude that parties rarely craft their own à la carte rules or fine-tune the procedures used to resolve their disputes. Accordingly, many commentators have decided that procedural customization is a theoretical phenomenon that is interesting only because of its absence in practice. Part II turns, however, to an integrative appraisal of existing empirical work. In looking across studies, this analysis reveals underappreciated pockets of procedural contracting. By weaving together

20. See, e.g., Adam B. Badawi, *Interpretive Preferences and the Limits of the New Formalism*, 6 BERKELEY BUS. L.J. 1, 54 (2009) (“That there may be instrumental reasons for transactors to prefer more contextual types of contract interpretation”); Theodore Eisenberg & Geoffrey P. Miller, *The Flight from Arbitration: An Empirical Study of Ex Ante Arbitration Clauses in the Contracts of Publicly Held Companies*, 56 DEPAUL L. REV. 335, 350 (2007) (“[T]he type of contract involved is the strongest indicator of whether or not the contract contains an arbitration clause”); Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text and Context: Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23, 96–97 (2014) [hereinafter Gilson, Sabel & Scott, *Text and Context*] (surmising that some approaches to contract design prefer ex post adjudication).

various threads of existing research, Part II paints a more comprehensive, if still contingent, picture of the reality of procedural autonomy.

Part III anticipates procedural innovation by identifying key features in the transactional environment that incline contracting parties to choose particular procedural governance mechanisms. Part III borrows from recent literature that addresses contracts for innovation to distinguish between different types of commercial party transactions, which can be usefully segregated into four rough domains oriented along two axes: uncertainty and scale.²¹ In general, a positive correlation exists between the degree of uncertainty and the risk of litigation opportunism. And as scale increases, parties tend to rely less on formal methods of contract enforcement, turning instead to industry-provided norms, trade associations, and specialized arbitral tribunals. Accordingly, worries about litigation risk diminish as parties tend to forego formal contracts and formal enforcement. In short, the quadrants of the transactional space for contract design present varying degrees of litigation opportunism risk, and contract designers will predictably confront that risk through procedural tailoring in different ways.

I. The Benefits of Private Process

*[The contract] creates guardrails for the relationship. It doesn't solve all things but it shows what the[] parties can do and that's important because there is a lot of uncertainty and a lot of chaos.*²²

Contract design aims to secure incentives for parties in business relationships that require commitments over time. Central to the problem transactional attorneys face, then, is the need to adapt to unforeseen (and often unforeseeable) events that arise after contract formation. The greater the uncertainty about the future, the more difficult it becomes for transactional attorneys to anticipate and provide for contingencies in a way that courts or tribunals can readily interpret and enforce.²³ Contract theory

21. See Gilson, Sabel & Scott, *Text and Context*, *supra* note 20, at 29 (discussing the interplay between uncertainty and scale).

22. Gillian K. Hadfield & Iva Bozovic, *Scaffolding: Using Formal Contracts to Support Informal Relations in Support of Innovation*, 2016 WIS. L. REV. 981, 1010 & n.71 (quoting from an interview with a high-tech equipment provider).

23. See Gilson, Sabel & Scott, *Text and Context*, *supra* note 20, at 29 (“All else equal, the higher the level of uncertainty, the more difficult it is for parties to write and courts to interpret complete, state-contingent contracts.”).

has been devoted to understanding how parties adjust contractual obligations in light of this uncertainty.²⁴ To that end, theorists have attempted to diagnose exchange hazards and explore governance mechanisms available to mitigate or eliminate them.²⁵ Procedural customization represents another set of tools in the contract designer's toolbox.

The following sections explore the promise of procedural contracting. The first section briefly situates procedural contracting alongside other recent efforts to appreciate how parties address variegated transactional risks. The remaining sections explore how parties customize procedure to mitigate litigation opportunism.

A. The Design Space for Contracting and the Role of Procedural Autonomy

More than thirty years ago, Professor Ronald Gilson asked the question: "What do business lawyers *really* do?"²⁶ In a costless world, contract design would be a straight-forward task of pinning down efficient obligations for every possible future situation.²⁷ Of course, the world is not costless. Instead, contracts are always incomplete.²⁸ Transaction costs

24. *See id.* at 29 & n.13.

25. *See, e.g.*, Jennejohn, *The Private Order*, *supra* note 15, at 292 (arguing for a "multidimensional conception of exchange hazards" in order to assess more accurately the design of alliance contracts, which "involves a balancing of tradeoffs between more than one exchange hazard").

26. Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239, 241 (1984) [hereinafter Gilson, *Value Creation*]. Earlier answers to a similar question – "what good is contract law?" — had not been kind to lawyers. *See, e.g.*, Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55, 58, 61 (1963) [hereinafter Macaulay, *Non-Contractual Relations*] (noting that business interviewees complained that lawyers often got in the way of their business dealings, and that they preferred to do business by handshake rather than by contract). Interviews indicated that written contracts were often highly standardized documents that were largely confined to the drawer once drafted by the legal department and then rarely consulted to resolve disputes. *See id.* at 61.

27. *See* Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE W. RES. L. REV. 187, 190 (2005) (distinguishing between "obligational" complete contracts and "informationally" complete contracts).

28. *See, e.g.*, Richard Craswell, *The "Incomplete Contracts" Literature and Efficient Precautions*, 56 CASE W. RES. L. REV. 151, 154–55 (2005) (describing why a contract will never be "this" complete, including transaction costs and concern with the rules of interpretation); Oliver Hart & John Moore, *Incomplete Contracts and Renegotiation*, 56 ECONOMETRICA 755, 755 (1988) ("Since it may be prohibitively costly to specify, in a way that can be enforced, the precise actions that each party should take in every conceivable

include all of the many expenses associated with addressing contractual incompleteness.²⁹ Accordingly, Professor Gilson refocused contract theory by recognizing that business lawyers are really transaction cost engineers who economize expenses while constructing frameworks to govern their clients' relationships.³⁰ In a world of incomplete contracting, they use formal governance mechanisms to confront exchange hazards.³¹

eventuality, the parties are in practice likely to end up writing a highly incomplete contract.”); Avery W. Katz, *Contractual Incompleteness: A Transactional Perspective*, 56 CASE W. RES. L. REV. 169, 169 (2005) (“[E]xcept in the simplest and most basic transactions, contracting parties do not work out all of the relevant details and contingencies of their relationship at the outset.”); Schwartz & Scott, *supra* note 2, at 595 (“There is an infinite number of possible future states and a very large set of possible partner types. When the sum of possible states and partner types is infinite and contracting is costly, contracts must contain gaps. Parties cannot write contracts about everything.”); Robert E. Scott, *Rethinking the Default Rule Project*, 6 VA. J. 84, 85 (2003), https://www.law.virginia.edu/system/files/faculty/vajournal/vajournal_03.pdf (“As an organizing principle, the notion that contract rules are defaults inevitably leads to the conclusion that all contracts are inevitably incomplete.”); Kathryn E. Spier, *Incomplete Contracts and Signaling*, 23 RAND J. ECON. 432, 432 (1992) (“[Contracts] also tend to be incomplete, containing gaps that must be filled through renegotiation or legal intervention.”).

29. See OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM: FIRMS, MARKETS, RELATIONSHIP CONTRACTING* 78 n.7 (1985); see also R. H. Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1, 15 (1960) [hereinafter Coase, *The Problem of Social Cost*] (commenting that transaction costs are resources spent “to discover who it is that one wishes to deal with . . . 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”).

30. Gilson, *Value Creation*, *supra* note 26, at 241, 302; see also Victor Fleischer, Essay, *Deals: Bringing Corporate Transactions into the Law School Classroom*, 2002 COLUM. BUS. L. REV. 475, 478 (describing the Deals Program at Columbia Law School started by Ronald Gilson, Victor Goldberg, and David Schizer and discussing how it rested on the notion of lawyers focusing on deal mechanics in order to minimize transaction costs); see, e.g., VICTOR P. GOLDBERG, *FRAMING CONTRACT LAW: AN ECONOMIC PERSPECTIVE* 2 (2006) (“[T]he basic presumption that there are gains from trade is the economic foundation for a facilitative law of contract.”). Ronald Coase’s two most renowned papers teach that transaction costs are a central determinant of legal and organizational boundaries. See generally R. H. Coase, *The Nature of the Firm*, 4 *ECONOMICA* 386 (1937) (considering the boundaries of firms); Coase, *The Problem of Social Cost*, *supra* note 29 (arguing that in the absence of transaction costs parties will bargain to efficient results). As Coase later explained, however, the so-called Coase Theorem should be understood “as a stepping stone on the way to an analysis of an economy with positive transaction costs.” R. H. Coase, *The Institutional Structure of Production*, 82 *AM. ECON. REV.* 713, 717 (1992); see also OLIVER E. WILLIAMSON, *CONTRACT, GOVERNANCE AND TRANSACTION COST ECONOMICS* 5–7 (Gengxaun Chen ed., 2017) [hereinafter WILLIAMSON, *CONTRACT, GOVERNANCE AND*

Still, despite many advances in contract theory since Professor Gilson's seminal article, the contract design space remains something of a mystery.³² As Professor Robert Scott recognized in 2015, "[W]e know very little about the factors that influence how parties in the real world design their contracts."³³ Early contract theory tended to focus on only one type of governance mechanism—vertical integration—as a means of offsetting one type of exchange risk hold-ups.³⁴ But governance problems relate to various kinds of contractual externalities; holds-ups are one kind, but problems related to hold-ups manifest in a wide range of specific forms.³⁵ As a result, more and more scholars have been investigating particularized forms of exchange risks and the mechanisms that parties use to address those risks.³⁶

For instance, recent work related to the braiding of formal and informal contract enforcement has demonstrated how parties use combinations of

TRANSACTION COST ECONOMICS] (“[I]f transaction costs are zero then parties . . . would costlessly bargain to an efficient result whichever way the property rights are assigned at the outset. In that event, the emperor really did have no clothes: externalities and frictions would vanish. That being preposterous, the real message was this: ‘study the world of positive transaction costs.’”).

31. See, e.g., Jennejohn, *The Private Order*, *supra* note 15, at 294 (“Any theory of contract design must have answers for two questions: First, what hazards to exchange must transacting parties confront? And second, what governance tools can parties use to eliminate, or at least check, those hazards?”); Oliver E. Williamson, *Comparative Economic Organization: The Analysis of Discrete Structural Alternatives*, 36 ADMIN. SCI. Q. 269, 277 (1991) (“The discriminating alignment hypothesis to which transaction-cost economics owes much of its predictive content holds that transactions, which differ in their attributes, are aligned with governance structures, which differ in their costs and competencies, in a discriminating (mainly, transaction-cost-economizing) way.”).

32. Robert E. Scott, *Contract Design and the Shading Problem*, 99 MARQ. L. REV. 1, 3 (2015) [hereinafter Scott, *Contract Design and the Shading Problem*].

33. *Id.*

34. Oliver E. Williamson was at the forefront of this work. Williamson developed this theory in a series of articles that were then consolidated and expanded in his seminal book, OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (1975). See also Oliver E. Williamson, *Markets and Hierarchies: Some Elementary Considerations*, 63 AM. ECON. REV. 316, 316–18 (1973) (explaining the variables that likely influence a firm's decision to either purchase goods on the spot market or produce the goods internally); Oliver E. Williamson, *The Vertical Integration of Production: Market Failure Considerations*, 61 AM. ECON. REV. 112, 112–23 (1971) (same); WILLIAMSON, *CONTRACT, GOVERNANCE AND TRANSACTION COST ECONOMICS*, *supra* note 30, at 7.

35. See Bengt Holmström & John Roberts, *The Boundaries of the Firm Revisited*, J. ECON. PERSP., Fall 1998, at 73, 86.

36. See *infra* note 38 and accompanying text.

complementary governance mechanisms to address the challenges they face in contexts of high innovation, where it would be difficult or impossible to prescribe a fixed outcome for a given collaboration.³⁷ This work replaces a binary, either-or approach to formal and informal contract enforcement with an understanding of governance mechanisms as a collection of tools that can be combined—mixed and matched—to confront alliance hazards. In at least some innovative contexts, formal and informal enforcement mechanisms can be effectively braided together to mutually reinforce one another.³⁸

Similarly, Professors Scott and Triantis’s landmark article, *Anticipating Litigation in Contract Design*, explores how parties balance ex ante and ex post specification of contract terms to “maximize the incentive bang for the contracting-cost buck.”³⁹ “By reaching the optimal combination of front-end and back-end costs, parties can minimize the aggregate contracting costs of achieving a particular gain in contractual incentives.”⁴⁰ Scott and Triantis demonstrate how these tradeoffs help parties address particular contracting problems.⁴¹ For example, vague terms, which reduce upfront contracting costs but increase backend costs, can be valuable when one party’s inputs would be difficult or impossible to verify, or even observe, ex ante but will become clear by the time of performance. The critical point is that, like the braiding literature, *Anticipating Litigation* honed in on specific governance tools to solve specific transactional problems. By dissolving the binary choice between ex ante specification and ex post enforcement, Scott and Triantis demonstrated how contract designers are able to address efficiently an uncertain future.

In the same spirit as these efforts, procedural customization gives parties additional governance strategies for dealing with various instantiations of opportunism inherent in the ex post adjudication of breach-of-contract

37. See generally 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 (2010) [hereinafter Gilson, Sabel & Scott, *Braiding*] (evaluating the relationship between formal and informal contract enforcement); Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009) [hereinafter Gilson, Sabel & Scott, *Contracting for Innovation*] (examining the braiding of explicit and implicit obligations and their interaction within formal governance).

38. See Hadfield & Bozovic, *supra* note 22, at 1018–19.

39. Scott & Triantis, *Anticipating Litigation*, *supra* note 1, at 823.

40. *Id.* at 817.

41. See *id.* at 835–39.

claims through what has been called “shading.”⁴² Shading occurs because the legal conclusion that a party has breached can only be made after the parties present self-interested evidence to a court or tribunal.⁴³ Looking at that imperfect evidence, a court makes a comparative, probabilistic assessment of each side’s behavior, and the potential for adjudicatory error drives some parties to exploit the litigation process.⁴⁴

Regulating shading through substantive terms in the contract proves difficult because exogenous factors determine which party will behave opportunistically. Making matters worse, any effort to design the contract in a way that precludes one party from asserting an opportunistic claim inevitably increases the risk that the other party will engage in strategic behavior.⁴⁵ Ultimately, using substantive contract terms “to try to induce cooperative behavior from an uncooperative actor is like trying to pick up mercury; every provision stipulated or contingency appended just creates another source of contention open to various interpretations and is thus subject to manipulation in court.”⁴⁶ And, as if that were not enough, opportunistic litigation behavior can also be difficult to observe and even more difficult to verify.⁴⁷

Procedural customizations, however, can make headway on shading problems. In this regard, pre-dispute private ordering can be far more effective than post-dispute private ordering for at least three reasons. First, before a dispute, parties cannot accurately predict how a dispute will arise or what side of the issues they will each take. This uncertainty affords parties a degree of objectivity that they lack by the time a dispute foment,

42. Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 8; *see also* Juliet P. Kostritsky, *Plain Meaning vs. Broad Interpretation: How the Risk of Opportunism Defeats a Unitary Default Rule for Interpretation*, 96 KY. L.J. 43, 48 (2007) (“Opportunism is made possible by the inability of the bargaining parties to specify their obligations in light of future contingencies and behavioral choices, and this in turn drives the need to have an interpretation of the contract in order to determine obligations in a way that curbs opportunism in light of those contingencies and choices.”).

43. *See* Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 12–13.

44. *See, e.g.*, Alan Schwartz, *Relational Contracts in the Courts: An Analysis of Incomplete Agreements and Judicial Strategies*, 21 J. LEGAL STUD. 271, 317 (1992) (describing that sometimes parties to a contract take a “backward” approach where they “attempt[] to choose terms that are ‘renegotiation proof’—that is, optimal in all future states—or, failing this, that are likely to produce maximizing renegotiations”).

45. *See* Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 6.

46. Scott E. Masten, *Equity, Opportunism, and the Design of Contractual Relations*, 144 J. INSTITUTIONAL & THEORETICAL ECON. 180, 182–83 (1988).

47. *See* Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 6.

allowing them to make less emotionally charged choices about procedures and processes that will maximize their joint welfare.⁴⁸ In contrast, post-dispute, parties may seek to use procedural customizations as part of a strategy to generate litigation opportunism.

Second, transfer payments are much more feasible pre-dispute, and, particularly, at the outset of contracting. Accordingly, parties are able to contract for asymmetric procedural advantages, so long as the party that benefits purchases any such advantage from the other party for an agreed upon price.⁴⁹ In other words, parties can negotiate more complex procedural customizations because they can trade these customizations for substantive rights and obligations.

Finally, before a dispute arises, and especially during contract negotiation, parties enjoy the cooperative benefits of a deal-making ethos. They are thus less likely to succumb to various cognitive biases that might impede negotiating mutually beneficial procedural terms.⁵⁰ The relational norms inherent in pre-dispute bargaining can embolden the parties to make more even-handed decisions.

B. Regulating Litigation Opportunism Through Procedural Customization

Pre-dispute procedural contracting can address variations on shading in at least four ways: (1) eliminating or reducing the possibilities of post-dispute opportunism; (2) disincentivizing shading by reinforcing substantive obligations; (3) alleviating the harm of shading by generally mitigating the risks of litigation; and (4) reducing the costs of litigation directly.

48. See, e.g., Bruce L. Hay, *Procedural Justice—Ex Ante vs. Ex Post*, 44 UCLA L. REV. 1803, 1828–39 (1997) [hereinafter Hay, *Procedural Justice*] (describing the difference between ex ante and ex post perspectives when information differs); Christopher R. Drahozal, “Unfair” Arbitration Clauses, 2001 U. ILL. L. REV. 695, 746 (“Because no dispute has yet arisen, the parties can consider the range of possible disputes that might arise in agreeing on a dispute resolution forum.”). But see Robert G. Bone, *Agreeing to Fair Process: The Problem with Contractarian Theories of Procedural Fairness*, 83 B.U. L. REV. 485, 526–29 (2003) (criticizing some of the assumptions about information access that underlie typical ex ante arguments).

49. See Drahozal, *supra* note 48, at 746 (“[P]redispute arbitration agreements provide greater opportunities for making transfer payments than do postdispute arbitration agreements.”).

50. See generally Russell Korobkin, *Psychological Impediments to Mediation Success: Theory and Practice*, 21 OHIO ST. J. ON DISP. RESOL. 281 (2006) (discussing a range of cognitive biases that can prevent successful post-dispute negotiations).

1. Limiting the Possibilities of Post-Dispute Opportunism

Contract disputes generally arise because one party becomes disenchanted with the bargain that it originally struck. Whatever events precipitate the regret, if the dispute boils over into formal litigation, the parties must argue about the legal meaning of their actions to an adjudicator.⁵¹ In other words, while parties often describe conduct that contradicts their interpretation of a contract, breach is actually a legal conclusion that an adjudicator reaches after reviewing the facts and arguments that each side presents.⁵²

The trouble is that determining whether a breach has occurred can be quite challenging.⁵³ Proof costs are high, and errors are common.⁵⁴ Perhaps most significantly, adjudicators get their information from self-interested parties and are thus doomed to make their decisions despite a dearth of quality information regarding the relevant facts.⁵⁵ Moreover, the parties themselves may sincerely believe their own cover stories. As Professor Scott has explained, “It is very difficult for parties engaged in iterative acts of performance to interpret correctly the behaviors of their counterparty.”⁵⁶ Cooperation may be mistaken for defection and defection for cooperation, leading to retaliations (and counter-retaliations) that can, in turn, result in a

51. Of course, parties always have the opportunity to settle their dispute, but they will do so in light of predictions about how an adjudication would proceed. *See, e.g.*, Blair, *Promise and Peril*, *supra* note 14, at 793–96 (discussing the economics of settlement and the importance of adjudication to settlement).

52. Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 9.

53. *See, e.g.*, Chris Guthrie, *Misjudging*, 7 NEV. L.J. 420, 421 (2007) (“Empirical evidence suggests that judges possess three sets of ‘blindness’: informational, cognitive, and attitudinal blindness.”).

54. *See* Scott & Triantis, *Anticipating Litigation*, *supra* note 1, at 816 & n.4.

55. *See* ALEX STEIN, FOUNDATIONS OF EVIDENCE LAW 34–35, 73–106 (2005) (analyzing the sources of uncertainty in fact finding); ADRIAN VERMEULE, JUDGING UNDER UNCERTAINTY: AN INSTITUTIONAL THEORY OF LEGAL INTERPRETATION 4 (2006) (describing judicial ascertainment of the law as “choice under uncertainty” that implicates “limited information and bounded rationality”).

56. Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 13; *see also* Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. LEGAL ANALYSIS 561, 578 (2015) [hereinafter Bernstein, *Beyond Relational Contracts*] (“The biggest threat to continued cooperation is the possibility that a transactor will misclassify an act of cooperation as an act of defection and thus set off a series of actions and reactions that lead to the disintegration of the contracting relationship.”).

tangle of allegations.⁵⁷ Finally, deals that once seemed wise may, in light of subsequent events or better reason, seem foolhardy. The prospect of suffering large ex post losses can produce a form of amnesia that convinces both parties that their behavior remains consistent with their contractual obligations.⁵⁸ The earnestness of such after-the-fact justifications can muddle adjudicators as they attempt to make important credibility determinations.

In all the noise, the very real possibility of strategic maneuvering arises. Parties may leverage the difficulties with assessing breach to extort rents from their counterparties.⁵⁹ Customized procedural rules, however, can directly limit or eliminate certain kinds of costly post-dispute behavior—for example, by escalating the costs of discovery or engaging in abusive motion practice.⁶⁰ Customized procedure can also cabin post-dispute opportunism by constraining the range of matters over which the parties might disagree in the first place.⁶¹

57. See Hadfield & Bozovic, *supra* note 22, at 986 (discussing this noise in the context of contracts for innovation).

58. Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 14.

59. See, e.g., Ronald J. Gilson & Robert H. Mnookin, *Disputing Through Agents: Cooperation and Conflict Between Lawyers in Litigation*, 94 COLUM. L. REV. 509, 514–15 (1994); Bruce L. Hay, *Civil Discovery: Its Effects and Optimal Scope*, 23 J. LEGAL STUD. 481, 500–01 (1994) (discussing how plaintiffs may use discovery strategically to impose costs on the defendant); D. Rosenberg & S. Shavell, *A Model in Which Suits Are Brought for Their Nuisance Value*, 5 INT'L REV. L. & ECON. 3, 3 (1985) (providing a formal analysis of the impact of nuisance suits); John K. Setear, *The Barrister and the Bomb: The Dynamics of Cooperation, Nuclear Deterrence, and Discovery Abuse*, 69 B.U. L. REV. 569, 584–86 (1989) (examining “the structure of the games of discovery”).

60. Concerns over discovery costs, of course, have motivated various changes to the public rules of procedure. See, e.g., *Bell Atl. Corp. v. Twombly*, 550 U.S. 544, 558–59 (2007) (adopting new heightened plausibility pleading standards because “proceeding to . . . discovery can be expensive” and “the success of judicial supervision in checking discovery abuse has been on the modest side”); Stephen N. Subrin & Thomas O. Main, *The Fourth Era of American Civil Procedure*, 162 U. PA. L. REV. 1839, 1850 (2014) (“Since 1980, the Federal Rules have been amended numerous times: the scope of discovery was narrowed; numerical limits restricted the amount of discovery; and new discovery conferences, pre-trial conferences, mandatory disclosures, and sanction rules encouraged closer judicial supervision of discovery.”); Jay Tidmarsh, *The Litigation Budget*, 68 VAND. L. REV. 855, 858 n.8 (2015) (“Amendments in the Federal Rules of Civil Procedure in 1980, 1983, 1993, 2000, and 2006 were principally designed to accomplish the related aims of limiting discovery and enhancing judicial power to manage litigation.”).

61. See Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 23–24.

With respect to both discovery and abusive motion practice, parties face a collective-action problem. In a highly simplified model, each party has the option to act in an abusive or reasonable manner when making discovery requests or conducting motion practice. Jointly, the parties would benefit from acting reasonably. Individually, however, each party would gain an advantage by engaging in abusive techniques while the other acts reasonably. But both parties know this and that the other is likely to defect and employ abusive techniques. In this situation, the equilibrium solution is for both parties to defect, thereby acting in an abusive manner, even though that leaves both parties worse off than if they had both acted reasonably. By binding themselves to a more limited slate of discovery options or more limited motion practice in advance of any dispute, the parties can reduce the likelihood that this prisoner's dilemma will arise and sap individual resources.⁶²

With respect to the range of matters over which parties might disagree, customized procedure can limit the discursive space within which disputes take place. Parties can mandate the use of joint experts, bind themselves to factual stipulations, or even bifurcate the adjudication of liability and damages, which would allow them to gain valuable information about the stakes of a dispute before the adjudicator considers the question of liability.⁶³ Each of these mechanisms short-circuits incentives for either party to engage in jointly wasteful posturing or distraction tactics. Instead, parties can preemptively focus the factfinder on the issues that are most relevant, or most likely to be relevant.

Other mechanisms are imaginable. The fundamental point, though, is that procedural contracts can directly prevent parties from strategically gaming the asymmetry between what they can observe and what an adjudicator can verify.

2. Reinforcing Substantive Obligations

In addition to directly eliminating or limiting the possibility of post-dispute opportunism, procedural customizations can work in tandem with other governance mechanisms to reinforce substantive obligations. By

62. The same logic could apply to waivers of the right to appeal. Parties might well dispense with a right to appellate review, before a dispute arises, because they believe that the collective value of enhanced accuracy is not worth the costs. *See* Setear, *supra* note 59, at 584.

63. *See, e.g.,* Drury Stevenson, *Reverse Bifurcation*, 75 U. CIN. L. REV. 213, 216–18 (2006) (discussing bifurcation of damages and liabilities).

preemptively reducing the likelihood that a dispute will occur, such procedural terms can indirectly reduce post-dispute opportunism. By altering procedural rules, parties can reinforce substantive commitments in at least three ways: (1) indirectly influencing when or how a party might shirk its substantive obligations by changing the expected value of the litigation; (2) sending credible signals about the likelihood of shirking; and (3) enhancing informal cooperation.

a) Altering the Expected Value of Litigation

Procedure factors into whether a party will engage in conduct that pushes the boundaries of what the substantive terms permit or constitutes a breach. Procedural rules impact how parties evaluate their post-dispute payoffs by influencing when (or if) parties assert their claims and how they make strategic choices during litigation.⁶⁴ The path to resolving a dispute will vary based on different considerations. Those considerations include the substantive law, the parties' agreement, "the procedural rules applied, the resources each side has and is willing to invest in dispute resolution, each side's estimation of the merits of the dispute, and each side's sensitivity to risk."⁶⁵ By tweaking procedural rules, parties can adjust the expected payoffs of litigation and the corresponding incentives to perform, breach, or shirk.

Parties commonly calibrate the difficulty of proving (or disproving) compliance with contractual terms by varying the precision of their substantive obligations.⁶⁶ When parties include terms that are vague or difficult-to-prove, like "best efforts," the high costs associated with introducing evidence to an adjudicator can dissuade parties from fighting. In contrast, when parties specify their obligations in precise terms that can be verified in court at a low cost, potential breachers may think twice about shirking or engaging in other opportunistic misconduct.

Pre-dispute procedural contracting offers parties even more options for incentivizing compliance with substantive obligations. Procedural contracting, in other words, can help overcome the "acoustic separation" between the *ex ante* and *ex post* understandings that parties have about how

64. See generally STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 392–401 (2004) [hereinafter SHAVELL, FOUNDATIONS]; Steven Shavell, *The Fundamental Divergence Between the Private and the Social Motive to Use the Legal System*, 26 J. LEGAL STUD. 575 (1997).

65. Blair, *Promise and Peril*, *supra* note 14, at 792.

66. See *id.* at 809–11.

their future disputes will be adjudicated.⁶⁷ For example, agreeing that expert testimony will be given by a neutral third party, rather than through party-appointed advocates, could incentivize greater compliance with performance standards pre-dispute. At the very least, such contracting could alter the parties' incentives in deciding which claims to bring and how much to invest in proving claims once they have been asserted. By agreeing to grant a potential defendant the right to exercise an option that would make any settlement unenforceable, parties could reduce litigation hold-up problems and eliminate a potential plaintiff's incentive to bring a negative-value lawsuit.⁶⁸ Or, by opting into expanded review of arbitral awards, parties could increase accuracy (and costs) to deter more questionable claims.⁶⁹ Parties could also employ alternative mechanisms—such as fee-shifting agreements and burden-shifting agreements—to raise the price of bringing non-meritorious or speculative claims and limit the risk of extortionate lawsuits.

67. See generally Meir Dan-Cohen, *Decision Rules and Conduct Rules: On Acoustic Separation in Criminal Law*, 97 HARV. L. REV. 625 (1984) (discussing Jeremy Bentham's distinction between the clear rules heard by the general public and the need for adjudicators to have flexibility in applying the rules to specific cases); see also Hay, *Procedural Justice*, *supra* note 48, at 1812 (distinguishing between *ex ante* and *ex post* perspectives).

68. See, e.g., David Rosenberg & Steven Shavell, *A Solution to the Problem of Nuisance Suits: The Option to Have the Court Bar Settlement*, 26 INT'L REV. L. & ECON. 42 (2006). The article evaluates cases where "the plaintiff's case is sufficiently weak" and provides that "[t]he solution is to give defendants the option to have courts prevent settlement, that is, to accord defendants the right to have courts declare that settlement agreements will not be enforced." *Id.* at 42.

69. See, e.g., Steven Shavell, *The Appeals Process as a Means of Error Correction*, 24 J. LEGAL STUD. 379, 384–87 (1995) (describing the cost and accuracy of the appeals process). Importantly, under the Federal Arbitration Act ("FAA"), parties cannot opt into enhanced judicial review of arbitral awards. See *Hall Street Assocs., L.L.C. v. Mattel, Inc.*, 552 U.S. 576, 584 (2008) ("We now hold that §§ 10 and 11 respectively provide the FAA's exclusive grounds for expedited vacatur and modification."). But section 10 of the FAA, which governs judicial review of arbitral awards, may not be preemptive. See *id.* at 590 ("In holding that §§ 10 and 11 provide exclusive regimes for the review provided by the statute, we do not purport to say that they exclude more searching review based on authority outside the statute as well."). Accordingly, parties may be able to seek enhanced judicial review in state courts. See Allen Blair, *Is Less Really More? Hall Street Associates, Private Procedural Ordering and Expanded Review of Arbitral Awards in State Courts*, 5 Y.B. ON ARB. & MEDIATION 74, 97–105 (2013) (discussing five states that allow for parties to opt into enhanced judicial review).

b) Sending Credible Signals

Procedural customization can also provide credible signals regarding the parties' willingness to cooperate, or the strength of their respective positions. Parties already signal the quality of their performance by providing (or disclaiming) warranties,⁷⁰ but they could go further. For instance, a manufacturer could signal confidence in its product by offering to bear the burden of proof in any lawsuit for breach.⁷¹ Or it might otherwise disarm itself by trading another litigation right—perhaps the right to choose the forum, remove a case to federal court, or obtain certain discovery—to demonstrate the strength of its position. Alternatively, for example, a tenant could signal reliability by agreeing to let the landlord quickly obtain provisional relief in the event of a default.⁷² Or, as frequently happens, a borrower could signal intent to repay by using a cognovit clause to stipulate to a default judgment in the case of non-payment.⁷³

By voluntarily committing to abandon what could otherwise be a useful litigation right, parties can convey valuable information to their contracting partners.⁷⁴ Such signals, in turn, can reinforce substantive commitments and minimize the risks of litigation opportunism.

70. See generally Esther Gal-Or, *Warranties as a Signal of Quality*, 22 CANADIAN J. ECON. 50 (1989) (explaining that warranties can signal quality but noting that limits on this contention).

71. “A variety of other customizations to burdens of proof can also be envisaged. A rich literature exists exploring the connections between the burden of proof, risk of error, primary behavior, and cost of litigation.” Blair, *Promise and Peril*, *supra* note 14, at 810–11 n.106 (citing key articles).

72. Daphna Kapeliuk & Alon Klement, *Contractualizing Procedure* 3, 24–25 (Dec. 31, 2008), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1323056 (unpublished manuscript).

73. See, e.g., Richard Hynes & Eric A. Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 174–75 (2002).

74. See generally Shay Lavie & Avraham Tabbach, *Litigation Signals*, 58 SANTA CLARA L. REV. 1, 3 (2018) (proposing “that informed defendants can ‘signal’ relevant information to uninformed plaintiffs without formal discovery”). Professors Lavie and Tabbach provide a comprehensive theory of litigation signaling, though primarily in the context of post-dispute stipulations. See *id.* at 10–19 (examining fee-shifting provisions, waiver of claims and defenses, and award modification agreements). The logic of many of their arguments, however, can usefully be extended to pre-dispute customizations. Although the accuracy of some signals may be more difficult to determine *ex ante*, as described at the outset.

c) Enhancing Informal Cooperation Mechanisms

Finally, pre-dispute procedural customizations could help clarify the informal norms that govern the parties' interactions in a particular context. Conventionally understood, litigation resolves a dispute by empowering a neutral third party (a judge or an arbitrator) to render a final and binding decision on the merits. The threat of litigation motivates parties to hew closely to their contractual obligations because they will be sanctioned when they do not.⁷⁵ Relational contract theory recognizes, however, that parties often perform out of respect for shared informal norms of behavior, not the threat of legal sanction.⁷⁶ Still, as Lon Fuller once suggested, neither the threat of sanctions nor the desire to comply with some overarching sense of morality exhaust the possible reasons for why parties comply with law.⁷⁷ Instead, law and informal norms may work in tandem.

75. See SHAVELL, FOUNDATIONS, *supra* note 64, at 392–401 (providing a comprehensive statement of the existing economics of public law enforcement, almost all of which concerns deterrence); see also Richard A. Posner, *Regulation (Agencies) Versus Litigation (Courts): An Analytical Framework*, in REGULATION VS. LITIGATION: PERSPECTIVES FROM ECONOMICS AND LAW 11, 11–12 (Daniel P. Kessler ed., 2010) (stating that the goal of the chapter “is to compare common law regulation with administrative regulation, while giving due recognition to the fact that administrators often use common law methods of regulation and that judges sometimes use methods similar to those of administrative agencies”); Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 1166 (2001) (stating that “a primary reason to permit individuals to sue is that the prospect of suit provides an incentive for desirable behavior in the first instance” and also noting that in some cases the prospect of suit deters future conduct).

76. See Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 ECON. INQUIRY 444, 449–50 (1996) (discussing the self-enforcing range of behavior); Janet T. Landa, *A Theory of the Ethnically Homogeneous Middleman Group: An Institutional Alternative to Contract Law*, 10 J. LEGAL STUD. 349, 350 (1981) (“But the real significance of the visible, surface structure of the [ethnically homogeneous middleman group] lies in its underlying deep structure: the invisible codes of ethics, embedded in the personalized exchange relations among the members of the EHM, which function as constraints against breach of contract and hence facilitate exchange among Chinese middlemen.”).

77. Lon L. Fuller, *Human Interaction and the Law*, 14 AM. J. JURIS. 1, 36 (1969) (“Much that is written today seems to assume that our larger society is enabled to function by a combination of the individual’s moral sense and social control through the threatened sanctions of state-made law. We need to remind ourselves that we constantly orient our actions toward one another by signposts that are set neither by ‘morals,’ in any ordinary sense, nor by words in lawbooks.”).

Legal rules often nudge parties toward compliance with the informal and shared norms.⁷⁸ The growing literature on braiding formal and informal enforcement mechanisms rests on this notion.⁷⁹ Rather than competing, formal and informal governance mechanisms can be combined to provide a framework that builds and enhances trust over time. Formally imposed penalties, often focusing on information sharing and constitutive rules (including rights to termination) are used to grow relational expectations and norms. These norms, in turn, allow non-contractible terms of a deal to be renegotiated or shaped by incentives to avoid informal penalties, such as the loss of a relationship or reputation.

It may also be possible to conceive of the parties' agreement as influencing the mental frames, categories, or schema through which individuals understand and construct the social world.⁸⁰ For instance, Professors Oliver Hart and John Moore propose a more expressly psychological role for contracts.⁸¹ In their model, one party is motivated to underperform on non-contractible terms of a deal if she is aggrieved by her counterparty's own exercise of discretion in performance.⁸² Contracts can help avoid this outcome by anchoring expectations and feelings of entitlement. In turn, contracts delimit what might be called "aggrievement risk"—the range of justifiable loss that disappointed parties are likely to experience.

No matter the precise theoretical underpinnings, contract designers recognize that contracts play critical roles in fostering informal norms and

78. See Gilson, Sabel & Scott, *Contracting for Innovation*, *supra* note 37, at 435 ("This braiding creates an interactive process that constrains opportunism as the parties' investments in detailed knowledge of each other's character and capabilities raise switching costs—the costs one party to a contract must incur in order to replace the other party to the contract.").

79. *See id.* at 433–36.

80. See Jack M. Balkin, *The Proliferation of Legal Truth*, 26 HARV. J.L. & PUB. POL'Y 5, 5–10 (2003) (noting that "there are several different ways that law can make things true" and then arguing that "law is continuously proliferating truth into the world" by framing or defining facts or events); Cass R. Sunstein, *How Law Constructs Preferences*, 86 GEO. L.J. 2637, 2637–44 (1998) (arguing that "[o]ften preferences and values are constructed, rather than elicited, by social situations" and then demonstrating how law plays a constructive role).

81. Oliver Hart & John Moore, *Contracts as Reference Points*, 123 Q.J. ECON. 1, 1–3 (2008).

82. *Id.* at 5–7.

commonly include coordination provisions.⁸³ These provisions mitigate the risk of misunderstanding by structuring the means of efficient collaboration and clarifying each party's role.⁸⁴ Contractual coordination provisions reflect a behavior-based orientation.⁸⁵ Such provisions specify the parties' mutual goals and provide concrete, as well as more aphoristic, ways for them to align their efforts.⁸⁶ Additionally, the threat of third-party involvement nudges the parties into compliance.

Procedurally, many forms of alternative dispute resolution rest on the same core intuition: while parties may need nudges from third parties to reduce the risk that conflicting interests or misunderstandings will lead to corrosive disputes, they do not necessarily need formal enforcement. However, additional forms of pre-dispute procedural customizations could amplify the effects of braiding, coordination provisions, and alternative dispute resolution commitments.

For example, in some circumstances, it makes sense for parties to condition their behavior on some observable, random feature of the world—in other words, to correlate an equilibrium. The fundamental insight of correlated equilibria is that parties with sufficiently rich opportunities to communicate can negotiate strategies that limit, or eliminate, the incentive to defect.⁸⁷ Professors Jennifer Brown and Ian

83. See, e.g., Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089, 1126–30 (1981) (discussing the purpose and functions of hortatory rhetoric in enforcing the standards of loyalty and fidelity of fiduciaries); Elizabeth S. Scott & Robert E. Scott, *Marriage as Relational Contract*, 84 VA. L. REV. 1225, 1230 (1998) (arguing that marriage is a relational contract and contending that marital vows “describe a standard of performance in idealized and general terms, and remind the parties of their goal of maintaining a caring, cooperative relationship” even though such vows are not legally enforceable).

84. See Steven R. Salbu, *Evolving Contract as a Device for Flexible Coordination and Control*, 34 AM. BUS. L.J. 329, 329 (1997) (“When parties abide by contractual terms to avert these costs, contractual control is largely invisible, operating within the private decision-making realms of individuals or firms.”).

85. See *id.* at 332 (defining coordination as “the organization of goals, priorities, and programs for the future, the ordering of the desires and expectations between or among the transacting parties, and the adjustment of individual behaviors to accommodate the schedules and functions selected for mutual endeavor”).

86. *Id.* at 333.

87. See generally Robert J. Aumann, *Correlated Equilibrium as an Expression of Bayesian Rationality*, 55 ECONOMETRICA 1 (1987) (describing the role communication and knowledge of other parties' planned courses of action play in guiding decisionmaking); Robert J. Aumann, *Subjectivity and Correlation in Randomized Strategies*, 1 J.

Ayres use this idea to explain a value-enhancing function of mediation.⁸⁸ They demonstrate that a mediator who randomly chooses between alternative resolutions of a dispute can produce a solution that benefits both parties.⁸⁹

While Brown and Ayres make their point by considering a battle of the sexes game, the insight applies to other impasses from game theory—including, perhaps most usefully for the purposes of thinking about pre-dispute procedural innovations, hawk-dove games.⁹⁰ In a hawk-dove game, each player selects between an aggressive “Hawk” strategy, where she demands her way, and a passive “Dove” strategy, where she defers to others.⁹¹ In a two-person version, both players rank the four possible outcomes as follows, from best to worst: (1) playing Hawk against Dove; (2) playing Dove against Dove; (3) playing Dove against Hawk; and (4) playing Hawk against Hawk.⁹² The pure strategy equilibria are Hawk/Dove

MATHEMATICAL ECON. 67 (1974) (utilizing zero-sum games as an exemplar of incentivized cooperation); *see also* Richard H. McAdams, *The Expressive Power of Adjudication*, 2005 U. ILL. L. REV. 1043, 1050–57 (discussing correlated equilibrium and “explain[ing] the relevance correlated equilibria may have to adjudication, extend[ing] the existing theory, and then describ[ing] some critical objections to it”).

88. *See generally* Jennifer Gerarda Brown & Ian Ayres, *Economic Rationales for Mediation*, 80 VA. L. REV. 323, 324 (1994) (discussing “how mediators . . . can create value in negotiations between rational actors”).

89. *Id.* at 334.

90. Conventionally described, players in a battle of the sexes game choose between Strategy O and Strategy B where matching the strategies (OO or BB) produces a higher payoff for both players than failing to match (OB or BO). The two matching outcomes are equilibria. The players each prefer reaching either equilibrium to either of the two non-equilibrium outcomes. *Id.* at 374 (“Even though player 1 strongly prefers going to the opera, this player prefers attending the ballet with player 2 to the expected outcome of the mixed-strategy equilibrium.”). But the gains from each matching equilibrium are not equally shared, so each party prefers one over the other. *Id.* at 374–75. If each player selects the strategy necessary to produce her desired outcome (for instance Player 1 picks O and Player 2 picks B), the result is one of the non-equilibrium outcomes, which hurts both parties. *Id.* at 374. Without a means of predictably and credibly correlating on strategy, both parties lose either by failing to agree or by misjudging what the other party will do. *Id.* Professors Brown and Ayres argue that a mediator can help resolve this impasse by randomizing recommendations and thus giving each party roughly a 50% likelihood of achieving her preferred outcome. *See id.* at 375. They go on to formally prove that this solution produces “more than a three-fold improvement over the unmediated mixed-strategy equilibrium.” *Id.*

91. *See, e.g.*, J. McKenzie Alexander, *Evolutionary Game Theory*, in 1 NEW HANDBOOK OF MATHEMATICAL PSYCHOLOGY 322, 343–44 (William H. Batchelder et al. eds., 2017).

92. *Id.*

and Dove/Hawk because, although Dove against Dove is a somewhat attractive outcome, each party could fare better by defecting and playing Hawk while the other plays Dove.⁹³

While both parties would prefer to play Hawk, this combination leads to the worst possible outcome.⁹⁴ In a Hawk/Hawk game, the parties agree on the worst outcome based on their shared incentive to choose a strategy that could lead to that outcome. But parties cannot necessarily coordinate a tenable solution on their own, unless they both commit to never playing Hawk. Instead, however, parties can commit to giving a decision maker limited post-dispute authority to prevent a disastrous clash of wills—that is, to prevent both parties from simultaneously playing Hawk and give each party a roughly equal chance to reap the benefits of being a Hawk.

In short, pre-dispute procedural commitments can help focus parties on solutions to coordination problems and avoid the significant investment required in fact discovery and presentation of evidence. Both mediation requirements and highly streamlined arbitration procedures could serve this function. If parties elect for arbitration, baseball arbitrations, which significantly limit the parties' ability to present evidence, may be a useful format to follow.⁹⁵

3. *Mitigating the Risks of Litigation*

Parties often find themselves wedged between climbing costs and unpredictable judgments. Of course, if the risk premium of pursuing litigation exceeds whatever gains a party expects, that party should be willing to fully settle. But, as discussed in a previous article, there are many reasons why parties might want to rein in the riskiness of dispute resolution but still continue their fight.⁹⁶ Various forms of procedural contracting can hedge against outlier outcomes by reducing the risks posed by shading and producing more useful litigation.

93. *Id.*

94. *Id.*

95. See Benjamin A. Tulis, *Final-Offer "Baseball" Arbitration: Contexts, Mechanics & Applications*, 20 SETON HALL J. SPORTS & ENT. L. 85, 85 (2010) (explaining that final-offer or baseball "arbitration limits an arbitrator to choosing a final offer made by one of the parties involved in an arbitration proceeding").

96. Blair, *Promise and Peril*, *supra* note 14, at 797–99 (providing three reasons "why even rational parties might reach different expected judgment values and thus choose to adjudicate rather than fully settle," including (1) "judging is difficult," (2) scarcity of information, and (3) agency problems).

For instance, parties might opt to waive a jury. Although using a judge as a factfinder may reduce the overall costs of adjudication (by eliminating the time and effort that goes into empaneling a jury and streamlining presentation of evidence), perhaps the most important reason parties choose to try a case before a judge is that judges tend to be predictable and conservative decision makers. A sizeable literature addresses the possibility that juries are less predictable and produce more extreme decisions.⁹⁷ Thus, eliminating a jury can stabilize litigation expectations.

Parties may carry this logic further and opt to waive recourse through public courts and judges and instead choose their own adjudicator in arbitration. Arbitration is, in many cases, quicker and cheaper than resorting to courts.⁹⁸ But perhaps more importantly, arbitration enables the parties to choose a decision maker with greater expertise in the subject matter of the dispute.⁹⁹ Essentially, opting into arbitration and specifying arbitrator expertise can render litigation even more predictable, in certain circumstances, than if the parties tried their case before a judge.

In addition to selecting a decision maker, parties might reach some form of award-modification agreement. So-called “baseball arbitration,” or final offer arbitration, provides a good example. In baseball arbitration, parties each submit a “final” offer of judgment, and the arbitrator must award one

97. See, e.g., John Lande, *Failing Faith in Litigation? A Survey of Business Lawyers' and Executives' Opinions*, 3 HARV. NEGOT. L. REV. 1, 33–34 (1998) (presenting evidence from interviews and surveys suggesting that juries are less accurate and more extreme); Cass R. Sunstein, *Deliberative Trouble? Why Groups Go to Extremes*, 110 YALE L.J. 71, 102–03 (2000) (identifying group polarization as a possible explanation for jury extremism).

98. Christopher R. Drahozal & Stephen J. Ware, *Why Do Businesses Use (or Not Use) Arbitration Clauses?*, 25 OHIO ST. J. ON DISP. RESOL. 433, 451 (2010) [hereinafter Drahozal & Ware, *Why Do Businesses?*] (citing Christopher R. Drahozal, *Arbitration Costs and Forum Accessibility: Empirical Evidence*, 41 U. MICH. J.L. REFORM 813, 840 (2008)).

99. See, e.g., Richard W. Naimark & Stephanie E. Keer, *International Private Commercial Arbitration: Expectations and Perceptions of Attorneys and Business People: A Forced-Rank Analysis*, 30 INT'L BUS. LAW. 203, 204 tbl.1 (2002) (identifying arbitrator expertise as a factor in choosing arbitration over other forms of adjudication); DOUGLAS SHONTZ ET AL., RAND INST. FOR CIV. JUST., BUSINESS-TO-BUSINESS ARBITRATION IN THE UNITED STATES: PERCEPTIONS OF CORPORATE COUNSEL 16 (2011), http://www.rand.org/content/dam/rand/pubs/technical_reports/2011/RAND_TR781.pdf (reporting that almost 70% of corporate-counsel survey respondents listed “the ability to control the arbitrator’s qualifications” as an attribute that encourages arbitration).

of those offers.¹⁰⁰ Baseball, or final offer, arbitration functions not only to delimit arbitrator discretion, but also to incentivize parties to make more reasonable demands.¹⁰¹ If the arbitrator considers one party's demand excessive or extreme, the arbitrator will likely award the other party's final offer. This sort of dispute resolution simultaneously curtails risks of adjudicator error and dissuades at least the most extreme forms of opportunistic litigation posturing.

Beyond entering into agreements that select the decision-maker or modify a potential award, parties can also mitigate litigation risks in other ways. The key point is that parties can bracket the risks associated with litigation by stipulating to certain procedures ahead of time. By eliminating risks associated with a decision maker's discretion or the opposing party's extortionate demands, they can prevent extreme outcomes.

4. Directly Reducing the Costs of Litigation

Perhaps most intuitively, parties can agree to pre-dispute customizations that directly reduce the costs of litigation. By avoiding wasteful litigation expenditures, parties can unlock a critical advantage of procedural contracting.

Parties already modify procedure ex post by adjusting the timing and other pedestrian aspects of litigation. These minor post-dispute, procedure-modification agreements reduce costs by allowing the parties to disperse their obligations sensibly, avoiding what can be an expensive bunching or inefficient overlapping of deadlines. But parties can do more ex ante to simplify or streamline the dispute resolution process. Such procedures may include the following: waivers of rights to present oral testimony; waivers of objections to personal jurisdiction; waivers of rights to appeal; agreements to treat a summary judgment proceeding as a trial on the merits; agreements to expedited trials with a magistrate judge, or to expedited arbitration processes; stipulations of facts; limits on discovery; and related mechanisms.

100. The process was first proposed by Carl Stevens in 1966. *See generally* Carl M. Stevens, *Is Compulsory Arbitration Compatible with Bargaining?*, INDUS. REL., Feb. 1966, at 38.

101. *See* Tulis, *supra* note 95, at 89 (“Although the purpose of final-offer arbitration is to avoid an arbitration hearing, it is the presence of the final-offer arbitration process that promotes good-faith bargaining and drives the negotiations toward settlement, not the negotiations themselves.”).

More innovatively, parties could cap their expenditures through litigation budgets, which could be absolute or scaled to the amount in controversy.¹⁰² Essentially, in such a circumstance, each party could present a proposed litigation budget. A court or tribunal would then examine the proposed budgets in light of the needs of the case and lock in the amount that each party can spend on the litigation. British courts have used a variation of this system since 2013.¹⁰³

As with other sorts of procedural alteration, parties can directly reduce the costs of litigation through pre-dispute customizations. By reducing costs, parties can eliminate—or at least reduce—the harm caused by any post-dispute opportunism.

C. Summary

Contract enforcement has long been underappreciated in contract design. For years, contract theory treated judicial competence as a binary proposition: either courts could verify compliance with a party's contractual obligations, or they could not.¹⁰⁴ But the ability of a court or tribunal to verify a party's contractual performance is a matter of degree—it is not dichotomous.¹⁰⁵ In circumstances where adjudicators are more prone to errors, parties have greater room to engage in costly post-dispute opportunism or shading.¹⁰⁶

Pre-dispute procedural customization can offer parties a variety of mechanisms for confronting this sort of litigation opportunism. Whether used individually or together, these mechanisms can work with substantive contract design to maximize the incentive gains from trade. We might then expect to see parties engaging in regular and robust procedural customization. As the next Part discusses, however, the story is more complicated.

102. See Tidmarsh, *supra* note 60, at 858 & n.8 (describing the focus on recent amendments to the Federal Rules of Civil Procedure to attempt to limit discovery costs).

103. These are called Precedent H Cost Budgets. See CPR 3.12–18 (U.K.).

104. Hadfield, *supra* note 4, at 162 (“For the most part, competence has been treated as an either/or proposition: courts either can or cannot verify a potential contracting variable.”).

105. *Id.* (“Verifiability is a matter of degree not dichotomy; judicial competence is more or less limited because courts make errors more or less frequently in ‘observing’ a contract variable or translating an observation into a conclusion about efficiency.”).

106. *Id.*

II. Current Empirical Evidence Regarding Party Procedural Customization

Given the potential benefits of procedural customization to address litigation opportunism, parties seemingly have a lot to gain from routinely fine-tuning procedure in their contracts. Much of the existing empirical evidence, however, does not support this prediction.¹⁰⁷ Instead, public procedural rules seem to exert a strong gravitational pull.¹⁰⁸ As a result, a number of empirical studies have attempted (expressly or implicitly) to gain insight into what Professor David Hoffman has dubbed “the procedural dog that has not barked.”¹⁰⁹

It is important to note, upfront, the limitations of existing evidence. To date, only two studies purport to paint a comprehensive picture of pre-dispute procedural customization.¹¹⁰ Other studies tend to focus on isolated procedural modification provisions, or groups of provisions, and few studies differentiate data sets based on transaction type.¹¹¹ Accordingly, the extant empirical evidence remains tentative and incomplete.

This Part, however, comprehensively reviews the existing evidence and reveals a general, though still nascent, picture of procedural contracting. That picture turns out to be more complicated and nuanced than early analyses suggested. As early studies showed, parties routinely customize procedure through the selection or omission of coarse bundles of rules.¹¹² But contrary to what has been assumed at times, these modifications do not exhaust the range of customization observed in practice. Instead, parties occasionally make more granular—albeit modular—customizations to enhance the resolution of procedure. For example, parties may apply

107. See, e.g., Robert G. Bone, *Party Rulemaking: Making Procedural Rules Through Party Choice*, 90 TEX. L. REV. 1329, 1342 (2012) [hereinafter Bone, *Party Rulemaking*] (“Committing to an action in advance can make both parties better off in expectation, but it also can raise concerns about the bargaining conditions that give rise to the agreement. Committing to a general rule raises additional and possibly more serious concerns when the chosen rule deviates sharply from the background rules in place.”).

108. See *id.* at 1334 n.22 (discussing literature that emphasizes using public rules).

109. Hoffman, *supra* note 10, at 394.

110. Some limited empirical work has been conducted to evaluate the extent to which parties engage in post-dispute customization. Some commentators have speculated, however, that post-dispute customization is also rare. See Bone, *Party Rulemaking*, *supra* note 107, at 1342 (“I found very few examples of agreements entered into after filing, other than the usual stipulations for additional time and the like.”); Hoffman, *supra* note 10, at 393–94 (suggesting that procedure-related agreements are not as common as generally imagined).

111. See *infra* notes 145–60.

112. See *infra* notes 135–39.

different bundles of procedures on a claim-by-claim basis. Moreover, if parties opt out of the public dispute resolution system and into arbitration, they commonly engage in à la carte tailoring of particular details, such as how arbitrators are chosen and what standards of decision they use. Perhaps most intriguingly, some parties fashion extensive, detailed procedural frameworks that accomplish the following goals: (1) allocating dispute resolution work among various entities; (2) providing for formal and informal enforcement; and (3) offering intricate opportunities for information-sharing and trust-building—all while reducing the space within which conflict can fester.

This Part begins by reviewing the evidence, starting with the two comprehensive studies. It then turns to a brief overview of what more specialized studies can generally tell us about procedural contracting. It continues by summarizing recent scholarship that demonstrates how parties do, from time to time, engage in more robust and extensive procedural contracting—creating a bespoke framework within which the integrity and meaning of their contracts is tested and refined. Finally, this Part concludes by tying all the threads together to provide a mosaic of procedural contracting.

A. Two Comprehensive Studies of Procedural Contracting

The first study to examine the waterfront of procedural contracting was conducted by Professor Hoffman in 2014.¹¹³ While extremely useful as a starting point, this study ultimately carries only limited empirical weight, as Hoffman himself acknowledged.¹¹⁴ He conducted broad keyword searches of material contracts filed with the Securities and Exchange Commission (SEC).¹¹⁵ Consequently, his research does not provide precise information

113. Though Professor Hoffman's review is extensive, it excludes analysis of arbitration clauses. Hoffman, *supra* note 10, at 395 ("Most importantly, I am not going to talk much about contracts containing arbitration clauses."). As a result, his conclusions omit consideration of an important facet of procedural contracting. His justification for omitting arbitration is that the more informal nature of arbitration allows for easier ex post tailoring of procedural rules and, thus, makes it cheaper to forgo negotiations about procedural modifications ex ante. *See id.* at 393. This argument, however, overlooks other frictions that might impede post-dispute customizations and minimizes the importance of pre-dispute customization on the performance incentives of the parties.

114. *Id.* at 422.

115. *Id.* at 394, 404–05. Professor Hoffman also conducted a hand-coded analysis of 1200 credit card agreements, *id.* at 405–06, but my interest in this paper is on procedural autonomy between commercial parties.

about the frequency with which customizations occur or any consistent patterns of customization. Instead, his study facilitates general inferences about the relative prevalence of particular procedural terms, but the results are necessarily impressionistic.¹¹⁶ While he provided some of his text searches, he did not give enough information to allow subsequent researchers to replicate his findings.¹¹⁷ Nevertheless, because Hoffman was the first individual to evaluate systematically a wide range of procedural customizations, his conclusion is foundational: “[E]ven in circumstances where we would expect them to, parties almost never use [ex ante] contract terms to vary their post-dispute procedural contests.”¹¹⁸

However, it is worth noting that Hoffman’s own findings may caution against reading his conclusion for all it is worth. Indeed, despite his conclusion, he referenced a number of examples of particularized customizations, including the following:

- Approximately a dozen contracts requiring parties to plead particular claims as affirmative defenses;¹¹⁹
- A handful of examples of parties seeking to control court jurisdiction by waiving the right to remove, or stipulating to personal jurisdiction;¹²⁰
- Instances of parties “limit[ing] their counterparties’ ability to produce documents in suits with third parties—typically, in indemnification agreements”;¹²¹
- Dozens of examples of contracts where parties receive “inspection rights for particular classes of documents, whether or not in formal litigation”;¹²²
- Examples of parties contracting over evidence-preservation obligations;¹²³

116. *See id.* at 404–05 (“In this Part, I examine claims about the prevalence of particular kinds of procedural contracting beyond those studied in the literature to date.”).

117. *See id.* at 408 n.123 (providing only basic keywords).

118. *Id.* at 394.

119. *Id.* at 409 & n.124 (citing cases that required pleading claims as an affirmative defense).

120. *Id.* at 407–08.

121. *Id.* at 412 & n.141.

122. *Id.* at 412 & n.142.

- Hundreds of contracts varying the burden of proof, particularly in indemnification agreements;¹²⁴ and
- Dozens of examples of contracts “vary[ing] the burden of production.”¹²⁵

Perhaps most significantly, Professor Hoffman recognized that parties to arbitration agreements tend to engage in more individualized customization.¹²⁶ For instance, he found that “in many arbitration agreements, the parties specified the particulars of discovery.”¹²⁷ Additionally, he concluded “that parties often contract to permit hearsay testimony in arbitration” or waive other formal rules of evidence.¹²⁸ Overall, he found that arbitration clauses generally provide more “bespoke procedural clauses and that removing such contracts from the overall sample depressed rates at which bespoke procedure occurred.”¹²⁹

In 2015, Professor Mark Weidemaier extended Hoffman’s work by collecting and hand-coding a data set of 402 material contracts that were attached as exhibits to corporate SEC filings between January 1, 2000, and December 31, 2012.¹³⁰ He examined these contracts for a broad range of procedural terms, and by considering changes over time, he was able to draw inferences about how disruptive events or alterations in party attitudes stimulated behavioral shifts.¹³¹ As a result, his findings provide greater insight into how parties customize procedure.

Perhaps most significantly, Weidemaier found that parties do routinely engage in several forms of customization. In particular, in 76.1% of his sample contracts, parties incorporated bundles of procedures by including

123. *Id.* at 412 & n.143.

124. *Id.* at 413 (citing Scott & Triantis, *Anticipating Litigation*, *supra* note 1, at 867 n.165).

125. *Id.* at 414–15 & nn.156–58.

126. Importantly, as discussed in note 113, *supra*, Professor Hoffman does not focus on arbitration clauses, arguing that they present different issues. He nevertheless draws several conclusions about the prevalence of procedural customization in arbitration.

127. Hoffman, *supra* note 10, at 411–12.

128. *Id.* at 417–18 & n.173 (noting that he uncovered more than 200 arbitration agreements so doing).

129. *Id.* at 424 (speaking particularly about the Credit Card Database but speculating that the finding there implied a more general trend).

130. Weidemaier, *supra* note 18, at 1905–07.

131. *See id.* at 1908–09 & tbl.2.

an arbitration or forum selection clause.¹³² Parties also routinely included other provisions that chose between groups of procedures or opted out of procedures, including jury trial waivers in 15.2% of contracts without arbitration clauses,¹³³ carve-ins in 23.2% of contracts without arbitration clauses,¹³⁴ and attorney fee-shifting provisions in 23.9% of all contracts.¹³⁵ Indeed, even in contracts “without arbitration or forum selection clauses [] most include[d] at least one other procedural modification” that effectively selected or opted out of a set of procedural rules.¹³⁶

Like Professor Hoffman, Weidemaier observed that parties engage in more à la carte specification of procedural terms in arbitration than in public court litigation.¹³⁷ Parties who opt for arbitration commonly contract over the number of arbitrators, the qualifications or expertise of the arbitrators, arbitration costs, and at least some aspects of the hearing—including, such as the location of the hearing.¹³⁸ Weidemaier also observed that a significant minority of parties contract over standards of decision, which regulate the authority an arbitrator has to decide the merits of a dispute, as well as other rules affecting discovery procedures, pleading requirements, and evidentiary rules.¹³⁹

Notwithstanding his findings, Professor Weidemaier concluded that “[w]hat contracts almost never do—in either arbitration or litigation—is dictate the particulars of pre-trial and trial practice.”¹⁴⁰ Instead, parties rely on the procedural rules of the forum that they have chosen to specify terms

132. *Id.* at 1911–12. Procedural rules are generally provided by the forum. This number differs to some degree from other empirical studies. *See infra* Section II.B.2.

133. Weidemaier, *supra* note 18, at 1922 tbl.4.

134. *Id.* Professor Weidemaier defines a “carve-in” as a provision “that send[s] narrow questions, such as those involving scientific or financial matters, for binding resolution by private experts.” *Id.* at 1912. As Professor Weidemaier notes, such provisions are, at least sometimes, interpreted by courts as limited scope arbitration provisions. *Id.*

135. *Id.* at 1922 tbl.4 (finding that the loser pays attorney fees provision was located in 23.9% of all contracts).

136. *Id.* at 1912–13.

137. *See id.* at 1929 (“Taking these arbitration-specific clauses into account, parties who agree to arbitrate adopt, on average, significantly more additional customized procedures (3.4) than parties who designate a judicial forum as the default setting for resolving disputes (0.83).”).

138. *See id.* at 1925–28.

139. *See id.* at 1928–29 & tbl.5.

140. *Id.* at 1872; *see also id.* at 1931 (“Yet, aside from forum selection and choice of law clauses, [procedural contracting] rarely happens.”).

like pleading rules, evidence gathering, burdens of proof, and other similar issues.¹⁴¹

Similar to Professor Hoffman, however, Professor Weidemaier's conclusion may overstate his own findings. While both studies suggest that parties favor modular procedural customizations over more robust tailoring, it is clear that parties who provide for arbitration tailor procedure with more rigor.

B. Particularized Studies of Specific Procedural Contracting Terms

Outside of the studies conducted by Professors Hoffman and Weidemaier, other empirical investigations into procedural contracting focus on limited subsets of possible procedural customizations and look for evidence about how frequently parties incorporate specific provisions into their deals. Accordingly, their methodologies and conclusions differ. Nevertheless, in combination, these studies yield a general picture of procedural contracting in practice. With some exceptions, that picture generally reinforces the conclusion that most procedural customization is modular.¹⁴²

Strong evidence demonstrates that many commercial parties engage coarse forms of customization, primarily selecting between (or abandoning) bundles of procedural rights.¹⁴³ These particularized studies reveal the following trends:

- (1) Parties almost always include choice-of-law provisions;¹⁴⁴

141. *See id.* at 1930 (“Once again, however, relatively few contracts address routine procedural matters such as discovery, pleading, or evidence.”).

142. *See, e.g.,* O’Hara O’Connor et al., *supra* note 10, at 137 (“[D]espite the robust academic literature on the subject, real-world customization is largely absent, although we find some evidence that it is slowly increasing over time.”); Drahozal & O’Hara O’Connor, *Unbundling Procedure*, *supra* note 15, at 1989 (“[Parties do] almost nothing to change the procedural rules that would apply by default in these fora . . .”).

143. *See* Drahozal & O’Hara O’Connor, *Unbundling Procedure*, *supra* note 15, at 1955–61, 1990–91 (describing procedural contracting primarily as a choice between litigation and arbitration, supplemented by an election to reserve certain claims or remedies for an alternate forum).

144. *See, e.g.,* Theodore Eisenberg & Geoffrey Miller, *Ex Ante Choices of Law and Forum: An Empirical Analysis of Corporate Merger Agreements*, 59 VAND. L. REV. 1975, 1987 tbl.2 (2006) [hereinafter Eisenberg & Miller, *Ex Ante Choices*] (noting that all merger agreements in sample chose to designate a governing law, as the table shows none or not applicable to be zero); *see also* Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York: An Empirical Study of Choice of Law and Choice of Forum Clauses in Publicly-Held*

- (2) Parties regularly include forum selection clauses;¹⁴⁵
- (3) Parties frequently include arbitration clauses;¹⁴⁶
- (4) Arbitration clauses often provide for some “carve-outs” that allow parties to settle certain categories of disputes in court;¹⁴⁷
- (5) Parties commonly waive the right to jury trial;¹⁴⁸ and
- (6) Parties sometimes agree to allocate attorney fees.¹⁴⁹

Companies' Contracts, 30 CARDOZO L. REV. 1475, 1504 tbl.11 (2009) [hereinafter Eisenberg & Miller, *The Flight to New York*] (finding that all contracts studied contained choice of law clauses); Hoffman, *supra* note 10, at 410 (finding over 1000 contracts each year in text-based search of SEC material contracts selected the governing law to apply).

145. Findings vary from study to study, but the numbers seem to consistently support the conclusion that at least a third of commercial contracts include a forum selection clause. *See, e.g.*, Eisenberg & Miller, *Ex Ante Choices*, *supra* note 144, at 1987 (finding that 52.5% of a sample of merger agreements included choice of forum clause); Eisenberg & Miller, *The Flight to New York*, *supra* note 144, at 1503–04 (“The most prominent feature is the absence of forum clauses in 61 percent of the contracts.”); *see also* Matthew D. Cain & Steven M. Davidoff, *Delaware's Competitive Reach*, 9 J. EMPIRICAL LEGAL STUD. 92, 94 (2012) (finding that 60% of the merger agreements in the sample selected Delaware as their choice of forum); Hoffman, *supra* note 10, at 407–08 (concluding based on text search of SEC filings that “a plurality of contracts choose forum”).

146. *See, e.g.*, Drahozal & O’Hara O’Connor, *Unbundling Procedure*, *supra* note 15, at 1972–73 (finding that 47.5% of a sample of technology contracts included an arbitration clause, with substantial variation across contract types); O’Hara O’Connor et al., *supra* note 10, at 161 tbl.1 (finding that 51.5% of a sample of CEO employment contracts required arbitration of some or all disputes); *see also* Matthew C. Jennejohn, *Contract Adjudication in a Collaborative Economy*, 5 VA. L. & BUS. REV. 173, 197 (2010) (“[Parties to collaborative agreements] resort to arbitration far more often than commercial parties resolving disputes relating to more traditional types of commercial contracts.”).

147. For example, one study found such carve-outs in nearly half of a sample of CEO employment contracts. O’Hara O’Connor et al., *supra* note 10, at 167–68. Likewise, Drahozal and O’Hara O’Connor found routine use of carve-outs in arbitration clauses in samples of joint venture, technology, and franchise agreements. Drahozal & O’Hara O’Connor, *Unbundling Procedure*, *supra* note 15, at 1966–67 (“Carve-outs are present in essentially all franchise contract arbitration clauses, nearly two-thirds of domestic and cross-border technology contract arbitration clauses, and about one-half of domestic joint venture agreement arbitration clauses and CEO employment contract arbitration clauses.”).

148. Theodore Eisenberg & Geoffrey P. Miller, *Do Juries Add Value? Evidence from an Empirical Study of Jury Trial Waiver Clauses in Large Corporate Contracts*, 4 J. EMPIRICAL LEGAL STUD. 539, 541, 567 (2007) (finding about 20% of 2800 commercial contracts contained jury trial waivers, although also finding substantial variance across contract type, ranging from 1.9% to 64.5%).

In short, parties commonly choose where their disputes will be heard and who will resolve them.

Importantly, however, several of these studies observed that procedural customizations vary significantly depending on the type of transaction or category of dispute at issue.¹⁵⁰ For instance, Professors Erin O'Hara O'Connor and Christopher R. Drahozal have observed that parties in four types of transactions—technology contracts, CEO employment contracts, joint-venture contracts, and franchise contracts—use arbitration clauses with very particular carve-outs.¹⁵¹ These parties seek to protect their information and intellectual property rights through public courts rather than through arbitration.¹⁵² Specifically, O'Hara O'Connor and Drahozal find that “parties are opting to have claims related to their noncompete, confidentiality, and nonsolicitation clauses, as well as their trademark, copyright, and patent rights and trade secrets resolved in courts.”¹⁵³

Moreover, some customizations that seem generic or coarsely modular may, in combination, reflect more precise tailoring than previous studies suggested. For example, one recent and important paper by Darius Palia and Robert Scott collected evidence that indicates sophisticated parties often pair jury trial waivers with forum and choice-of-law clauses that

149. See Theodore Eisenberg & Geoffrey P. Miller, *The English Versus the American Rule on Attorney Fees: An Empirical Study of Public Company Contracts*, 98 CORNELL L. REV. 327, 352 tbl.2 (2013) (finding that 37.1% of the contracts in their sample adopted the American rule, while 36.4% adopted the English rule).

150. Theodore Eisenberg, Geoffrey P. Miller & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 MICH. J.L. REFORM 871, 895 (2008) (“However, corporations’ selective use of arbitration clauses against consumers, but not against each other, suggests that their use of mandatory arbitration clauses may be based more on strategic advantage than on a belief that corporations are better serving their customers.”); Drahozal & Ware, *Why Do Businesses*, *supra* note 98, at 457–67, 470–72 (contesting Eisenberg’s results and further arguing for differences between kinds of markets); Christopher R. Drahozal & Quentin R. Wittrock, *Franchising, Arbitration, and the Future of the Class Action*, 3 ENTREPRENEURIAL BUS. L.J. 275, 278 (2009) (noting that the limitation on class relief might be a consideration for inclusion of an arbitration clause).

151. See Erin O'Hara O'Connor & Christopher R. Drahozal, *The Essential Role of Courts for Supporting Innovation*, 92 TEX. L. REV. 2177, 2185 (2014) [hereinafter O'Hara O'Connor & Drahozal, *The Essential Role*].

152. See *id.* at 2180–81.

153. *Id.* at 2181.

select New York.¹⁵⁴ In isolation, each mechanism would appear to be a coarse modular refinement of procedure that could easily be lumped in with other routine but minor customizations. The paper concluded, however, that sophisticated parties are refining their contracts more carefully “to reduce the back end costs of litigation, especially the costs of contract interpretation disputes.”¹⁵⁵ Essentially, the study hypothesized that this combination of modular procedural alterations allows parties to lock the content of their contracts by selecting a jurisdiction that uses textualist contract interpretation rules to avoid the uncertainty associated with lay factfinders.¹⁵⁶ These provisions, in other words, are not mere boilerplate language that appears in standard merger and acquisition templates. Nor are they mere macro-level choices about bundles of procedure. Instead, parties seem to be evaluating their transaction-specific needs and tailoring their agreements to meet those needs by carefully selecting bundles of rules and procedures.¹⁵⁷

Overall, these particularized studies demonstrate that parties regularly customize procedure through bundles of pre-fabricated procedures. But these studies do not exhaust the waterfront of customization. Instead, at least occasionally, contracting parties make more concerted modular changes than contract theory scholarship previously recognized, thoughtfully pairing various procedural regimes with substantive provisions to maximize gains from trade.

C. Recent Evidence Demonstrating Highly Customized Procedural Contracting

Finally, at times, parties engage in robust and highly customized procedural contracting. Parties often select more granular, if still modular,

154. Darius Palia & Robert E. Scott, *Ex Ante Choice of Jury Waiver Clauses in Mergers*, 17 AM. L. & ECON. REV. 566, 586 (2015).

155. *Id.*

156. *Id.*

157. See Drahozal & O’Hara O’Connor, *Unbundling Procedure*, *supra* note 15, at 1950 (“By using carve-outs and carve-ins, parties can obtain a more carefully calibrated unbundling of procedure than an arbitration clause or forum-selection clause alone would provide, but at a much lower overall cost than the parties would incur by contracting for individual procedures. What often results is a sort of middle ground for bundling of procedural rules: parties choose among pre-set bundles of dispute resolution services, but unbundle the circumstances where any given dispute resolution bundle will be used. This phenomenon is common and widespread, observed with varying frequency across a number of different contracting contexts, and thus deserves more careful consideration.”).

procedures on a claim-by-claim basis. But, particularly in alliance agreements, where parties pool their specific capabilities to mutually exploit strategic interdependency, they also regularly create intricate procedural regimes. These regimes distribute dispute resolution among various decision makers (some private, some public) and provide feedback loops that generate additional information, bolster trust, and minimize the discursive space within which ongoing disputes can fester.

The segregation of disputes into various categories allows parties to direct different types of disputes to different tribunals, which apply different sets of rules and possess greater levels of expertise.¹⁵⁸ This resembles the coarser sorts of customization that earlier empirical literature identified—through the use of forum selection and arbitration clauses—but takes place at a higher degree of resolution.¹⁵⁹ As parties enter into more complex and collaborative deals, they become more reliant on granular procedural customization.¹⁶⁰

At some point, when the outcome of a collaboration becomes impossible to specify *ex ante*, parties layer in informal escalation procedures, often requiring that higher level managers resolve disagreements when subordinates become deadlocked.¹⁶¹ If an impasse cannot be overcome, formal modes of dispute resolution function as a backstop.¹⁶² Professor Stipanowich made the following observation nearly twenty years ago:

As lawyers and contracting parties have become more familiar with various strategies for out-of-court resolution of disputes, they have explored the possibilities of combining two or more approaches in multi-step dispute resolution programs. Such stepped “filtering systems”—increasingly visible in construction, commercial and employment contracts as well as the voluntary system employed by e-Bay for resolution of thousands of buyer/seller disputes—begin with informal negotiation and, if necessary, proceed to mediation; arbitration or litigation remains

158. *See, e.g., id.* at 1966–69 (analyzing the use of bifurcated dispute resolution provisions in a variety of agreement types). Professors Drahozal and O’Hara O’Connor provide a foundational starting point for the phenomena of “carve-outs.” *Id.*

159. *See, e.g., Jennejohn, The Private Order, supra* note 15, at 361–63 & tbl.5 (showing that in a sample set of 146 agreements, over one-third bifurcated or trifurcated dispute resolution between different adjudicators).

160. *See id.* at 361.

161. *See id.* at 361 fig.1.

162. *See id.* at 361.

a last resort. Anecdotal evidence suggests that it is a rare dispute that survives the initial steps of such programs.¹⁶³

This multi-stage dispute resolution approach not only helps resolve conflicts but also generates information and fosters ongoing engagement.¹⁶⁴

Professors Cathy Hwang and Matthew Jennejohn have observed a similar distributed dispute resolution process in merger and acquisition agreements.¹⁶⁵ They note that pre-closing disputes are often sent to specialized courts in Delaware, where injunctive relief is readily available.¹⁶⁶ Post-closing disputes are frequently bifurcated; while routine contract-based disputes are sent to state or federal courts, contingent consideration disputes—including those arising out of a purchase price adjustment or an earn out—are sent to arbitration, often before accountants.¹⁶⁷

Professor Andrew Verstein has also documented a related phenomenon in the context of construction disputes, where he observes how dispute resolution boards mollify construction contracts.¹⁶⁸ “Dispute [resolution] boards are panels of neutral experts . . . chosen by the parties and convened at the start of a construction project.”¹⁶⁹ By utilizing these boards, parties delegate ex post specification of terms to decision makers who are more experienced than generalized courts while preserving the option to escalate a dispute that the board did not satisfactorily resolve to an arbitrator.¹⁷⁰ While a board’s decision does not become binding as an adjudication, it provides transactional stability to parties by resolving uncertainty on a

163. Thomas J. Stipanowich, *Contract and Conflict Management*, 2001 WIS. L. REV. 831, 853 (footnote omitted).

164. *See infra* Part III.

165. Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NW. U. L. REV. 279, 328–29 (2018) (“A similar phenomenon occurs in M&A. Parties often modularize their dispute resolution by specifying that the forum of dispute resolution depends on which portion of the contract is at issue.”).

166. *Id.* at 328.

167. *Id.*

168. *See generally* Andrew Verstein, *Ex Tempore Contracting*, 55 WM. & MARY L. REV. 1869 (2014). The Article notes that it will be “[u]sing a unique cache of data only recently made available[] . . . [to] explore[] ex tempore contracting through a novel dispute management system now prevalent in the construction industry called a ‘dispute board.’” *Id.* at 1869.

169. *Id.* at 1896.

170. *See id.* at 1875, 1896–1908.

rolling basis, thereby generating ongoing information and the ingredients for trust.

Critically, parties sometimes create highly tailored enforcement systems by selecting modular bundles of procedures and applying different bundles to different categories of disputes. These systems are frequently more granular than some previous literature on carve-outs has appreciated. In addition, designers layer in multiple opportunities for informal exchanges of information and resolution. Combined, these systems demonstrate that parties are making bespoke decisions about where and how their disputes will be resolved.

D. Summary

The totality of currently available empirical evidence demonstrates that parties engage in procedural contracting with greater frequency and diversity than early commentators supposed. While the evidence suggests that a majority of parties customize procedure by choosing between, or opting out of, bundles of procedures, there are three important caveats. First, some parties engage in atomistic, modular customizations, for instance, by assigning some categories of disputes to one decision maker and other categories of disputes to another decision maker. Second, parties who opt out of the public adjudicatory system and arbitrate their disputes often engage in more à la carte customizations. Third, in some situations, parties design intricate dispute resolution regimes that blend formal and informal enforcement mechanisms to solve disputes, minimize the number of circumstances in which they may arise, and generate ongoing information and trust.

III. Anticipating Procedural Innovation

As the previous Part shows, parties can and do customize procedure in dramatic ways. But the diversity of design decisions researchers see in practice has, to date, not been mapped into predictable patterns. As a result, commentators have overlooked the pockets where most procedural contracting takes place.¹⁷¹ To gain a clearer picture of how transactional designers harness the power of procedural customization, I argue that both

171. See Drahozal & Ware, *Why Do Businesses*, *supra* note 98, at 553–54 (explaining the unpredictable and less elaborate nature of arbitration as applied to procedural contracts).

scholars and practitioners must recognize the impact that the transactional environment has on contract design.¹⁷²

A growing literature on contract interpretation provides a valuable starting point. Borrowing the typology advanced by Professors Gilson, Sabel, and Scott, commercial party transactions can be usefully segregated into rough quadrants oriented along two axes: uncertainty and scale.¹⁷³ The risk of litigation opportunism differs in these four domains. As a result, rational commercial parties should respond to that risk by using procedural customization in varying, but predictable, ways.

The following sections sketch an initial theory about when, how, and why parties will turn to procedural customization as the mix of uncertainty and scale changes. These sections provide the starting point for a more focused empirical investigation in the future. But, as these sections conclude, the theory maps fairly well onto the existing evidence that researchers have about procedural autonomy.

A. The Relationship Between Uncertainty and Litigation Opportunism

As a general matter, uncertainty and litigation opportunism are positively correlated. Uncertainty, as used here, refers to the degree of disruption to commercial practices caused by unforeseeable technological or market changes. As is customary in the literature, uncertainty should be distinguished from risk.¹⁷⁴ While risk can be quantified, uncertainty cannot.

Contracts are conventionally thought of as instruments to regulate rights and obligations. When uncertainty is low, parties, at the time of contracting, are in the position to understand or articulate well-defined rights and obligations in every relevant state of the world. In other words, “parties . . . can develop a shared and unambiguous understanding of what counts as contract performance.”¹⁷⁵ They may describe this through state-contingent contracts that rely on complete and formal specification of contract terms

172. Notably, some commentators have begun similar projects. *See, e.g., id.* at 460–63 (noting that arbitration clauses are most prevalent in ordinary contracts between businesses but are less likely to be found in contracts outside of the ordinary course of business, such as loan commitments and merger agreements).

173. *See* Gilson, Sabel & Scott, *Text and Context*, *supra* note 20, at 29.

174. The conventional distinction between uncertainty and risk applies here. *See generally* FRANK H. KNIGHT, RISK UNCERTAINTY AND PROFIT (1921) (distinguishing between threats where the likelihood of the peril is nonquantifiable (uncertainty) and quantifiable (risk)); *see also* PETER CLARKE, KEYNES: THE RISE, FALL, AND RETURN OF THE 20TH CENTURY’S MOST INFLUENTIAL ECONOMIST 154–57 (2009).

175. Hadfield & Bozovic, *supra* note 22, at 984.

with fewer open-ended standards.¹⁷⁶ Or, in thicker markets, they may accomplish this understanding through relatively stable and shared industry norms.¹⁷⁷

In either case, when uncertainty is low, parties can estimate risks and address them *ex ante* at low cost, minimizing the work of a court or tribunal should a dispute arise that leads the parties to seek formal enforcement. The parties agree on what performance is owed and only face difficulties of proof with respect to whether that performance was actually delivered.¹⁷⁸ Adjudicators are less mistake-prone, and parties are less likely to encourage them, resulting in little enforcement uncertainty. In short, the risks of litigation opportunism are minimal.

As uncertainty rises, however, so too does the risk that what the parties actually intended at the time of contract formation and what an adjudicator can verify will diverge. Uncertainty can develop in long-term contracts, transactions with extremely unpredictable outcomes, or contracts in which the parties' ultimate goal is not clear—such as firms collaborating to discover new applications of cutting-edge research.¹⁷⁹ As uncertainty emerges, it becomes more difficult to apportion tasks and specify prices. It may be too expensive (or even impossible) for the parties to foresee and appropriately describe the most probable contractual outcomes. At the most extreme levels of uncertainty, in contexts where parties align to develop a new product or service, Professors Gilson, Sabel, and Scott have demonstrated that parties shift contracting to a system that is capable of encouraging actions and setting the terms of the exchange rather than merely specifying outcomes.¹⁸⁰

Greater levels of uncertainty open the door for either party to strategically exploit the gap between the parties' original intentions and what can be verified by an adjudicator. As a consequence, as uncertainty rises, so too does the risk of litigation opportunism.

176. See Gilson, Sabel & Scott, *Text and Context*, *supra* note 20, at 58–60.

177. See, e.g., Macaulay, *Non-Contractual Relations*, *supra* note 26, at 62–65.

178. Hadfield & Bozovic, *supra* note 22, at 984 (“In legal language, we would say that the parties agree on the law (what performance is owed) and only face disagreements or difficulties of proof with respect to the facts (what performance was delivered).”).

179. See generally Gilson, Sabel & Scott, *Contracting for Innovation*, *supra* note 37 (evaluating how innovation-based contracting has evolved).

180. See generally *id.*

B. The Relationship Between Scale and Litigation Opportunism

The relationship between scale and litigation opportunism is more subtle. In general, increases in scale tend to decrease room for opportunism. Scale refers to the number of similar parties engaged in the same category of transaction.¹⁸¹ Where more parties share a particular set of contracting goals or challenges, it is more likely that they (or some trade association of which they are a part) will have created standardized solutions that create network and learning effects.¹⁸² These informal (or, more precisely, less formal, in the case of some arbitrations) enforcement mechanisms can be far more efficient at regulating parties' conduct than traditional public law and state-run courts.¹⁸³

As scale decreases, however, it becomes more difficult to craft standardized solutions to common contracting problems. With declining scale, parties become more reliant on formal contracts and formal modes of enforcement because the prerequisites for relational norms are weaker.

181. See Gilson, Sabel & Scott, *Text and Context*, *supra* note 20, at 29 (“The second is the scope, thickness, or scale of the market—whether there are many traders or few engaged in a particular class of transaction using similar contracting strategies.”) (footnote omitted); Hadfield & Bozovic, *supra* note 22, at 983–85 (distinguishing between “well-developed industrial settings and relatively stable competitive environments” and “relationships aimed at innovation[,]” which are “subject to pervasive uncertainty[.]”).

182. Common use of a term or rule can create increasing returns for users. Brian Arthur is responsible for much of the leading work on increasing returns in the context of product markets. See generally W. BRIAN ARTHUR, *INCREASING RETURNS AND PATH DEPENDENCE IN THE ECONOMY* (1994) (including a collection of his works). Network externalities exist where “the utility that a user derives from consumption of a good increases with the number of other agents consuming the good.” Mark A. Lemley & David McGowan, *Legal Implications of Network Economic Effects*, 86 CALIF. L. REV. 479, 483 (1998) (quoting Michael L. Katz & Carl Shapiro, *Network Externalities, Competition, and Compatibility*, 75 AM. ECON. REV. 424, 424 (1985)). A distinction can be drawn between learning effects and network effects. See Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713, 717 (1997). Learning effects arise when a firm adopts a contract term that has been commonly used in the past, regardless of whether other firms will continue using it in the future. See *id.* at 718–25.

183. See, e.g., Barak D. Richman, *Firms, Courts, and Reputation Mechanisms: Towards a Positive Theory of Private Ordering*, 104 COLUM. L. REV. 2328, 2329 (2004) (“A more accurate opening would have been ‘Businesspeople need transactional assurance,’ where contracts and assorted regimes of contract enforcement comprise only one category of devices that produce the needed assurance.”).

Increasing reliance on contracts and legal enforcement, in turn, creates more room for litigation opportunism.

C. Litigation Opportunism in the Four Rough Domains of Commercial Party Transactions

While no hard boundaries exist, the two axes of uncertainty and scale roughly divide the world of commercial party transactions into quadrants. Each of these quadrants has a different litigation opportunism risk profile, and thus alters the ways in which rational contract designers will harness the power of procedural customization. At the simplest, because procedural contracting is most effective at addressing litigation opportunism, one would expect to see little procedural customization when the risks of such opportunism are low. And the role that procedural customization plays should be simple. Conversely, when the risks of litigation opportunism are higher, one would expect to see more tailored procedural customization designed to mitigate the latent risks that lurk beyond every turn.

1. Low Uncertainty, High Scale—Very Low Risk of Litigation Opportunism

Most transactions involve contracts whereby similar parties engage in routine transactions. These contracts, which commonly relate to commodities or routine sales of simple goods,¹⁸⁴ may involve risk but typically involve minimal uncertainty. In these environments, parties have little use for formal, written contracts and even less use for formal mechanisms designed to enforce existing contracts.¹⁸⁵ As a result, the risks of litigation opportunism are quite low, and rational contract designers will not invest in many procedural customizations.

More concretely, in contexts of low uncertainty and high scale, written contracts are standardized documents that are often relegated to a nondescript drawer once drafted by the legal department, and they are rarely consulted to resolve disputes.¹⁸⁶ The transacting parties operate

184. See, e.g., CHRISTIAN BÜHRING-UHLE, *ARBITRATION AND MEDIATION IN INTERNATIONAL BUSINESS* 11–12 (2006).

185. See O'Hara O'Connor & Drahozal, *The Essential Role*, *supra* note 151, at 2177 (“In most commercial exchange, formal legal principles and court systems play a surprisingly small role for transacting parties.”).

186. See, e.g., Hadfield & Bozovic, *supra* note 22, at 992–95; Macaulay, *Non-Contractual Relations*, *supra* note 26, at 61 (“Disputes are frequently settled without reference to the contract or potential or actual legal sanctions.”).

within large, well-developed industrial settings and relatively stable competitive environments. This allows them to appeal to established informal norms, rather than courts, when the need to interpret or adjust their behavior arises.¹⁸⁷ Stewart Macaulay famously described this process in 1963:

Most problems are avoided without resort to detailed planning or legal sanctions because usually there is little room for honest misunderstandings or good faith differences of opinion about the nature and quality of a seller's performance. Although the parties fail to cover all foreseeable contingencies, they will exercise care to see that both understand the primary obligation on each side. Either products are standardized with an accepted description or specifications are written calling for production to certain tolerances or results. Those who write and read specifications are experienced professionals who will know the customs of their industry and those of the industries with which they deal. Consequently, these customs can fill gaps in the express agreements of the parties.¹⁸⁸

187. Informal modes of enforcement can be quite effective in many circumstances. As Professor Macaulay discussed nearly thirty years ago, lived commercial practice often depends on non-legal relationship governance:

Contract planning and contract law, at best, stand at the margin of important long-term continuing business relations. Business people often do not plan, exhibit great care in drafting contracts, pay much attention to those that lawyers carefully draft, or honor a legal approach to business relationships. There are business cultures defining the risks assumed in bargains, and what should be done when things go wrong. People perform disadvantageous contracts today because often this gains credit that they can draw on in the future. People often renegotiate deals that have turned out badly for one or both sides. They recognize a range of excuses much broader than those accepted in most legal systems.

Stewart Macaulay, *An Empirical View of Contract*, 1985 WIS. L. REV. 465, 467–68; see also Russell J. Weintraub, *A Survey of Contract Practice and Policy*, 1992 WIS. L. REV. 1, 5 (“[I]t is a delusion to assume that commercial conduct is primarily controlled by what is ‘legal[.]’”) (footnote omitted); James J. White, *Contract Law in Modern Commercial Transactions, An Artifact of Twentieth Century Business Life?*, 22 WASHBURN L.J. 1, 1–2 (1982) (conducting an empirical study of chemical and pharmaceutical companies and offering the “thesis that contract law is a much less significant determinant of commercial behavior in complex transactions than the typical law student, contracts professor, or lawyer dares believe”).

188. Macaulay, *Non-Contractual Relations*, *supra* note 26, at 62–63.

Professors Gillian Hadfield and Iva Bozovic conducted a similar updated study in 2016 that confirms the same conclusions, at least for parties in contexts of low uncertainty and high scale.¹⁸⁹ These parties sell or manufacture standardized products with characteristics that are relatively easy to specify, “such as candies, brake systems, motorcycle wheels, plastic bags and undergarments.”¹⁹⁰ Hadfield and Bozovic found that these parties “paid little attention to formal contract terms” and “did not see courts as a significant means of enforcing contractual obligation.”¹⁹¹ “Instead, these businesses looked to industry and relational norms to adapt to contingencies and respond to the behavior of their contracting partners.”¹⁹²

Even when uncertainty rises slightly, if the scale is great enough and the community of transacting parties is relatively insular, the community can opt out of public courts and into legal systems run by trade associations—often arbitration—to resolve disputes.¹⁹³ According to Professor Bernstein, these sorts of systems may exist in “over fifty industries, including

189. See Hadfield & Bozovic, *supra* note 22, at 992–95.

190. *Id.* at 992.

191. *Id.* at 993, 994.

192. *Id.* at 993; see also Howell E. Jackson, *Regulation in a Multisectoral Financial Services Industry: An Exploratory Essay*, 77 WASH. U. L.Q. 319, 341 (1999) (noting prepayment and security as methods for insuring against nonperformance); Thomas J. Stipanowich, *Arbitration: The “New Litigation”*, 2010 U. ILL. L. REV. 1, 58 (concluding that mediation is an alternative mechanism to resolve disputes); Oliver E. Williamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519, 519–20 (1983) (arguing that hostage taking is “widely used to effect credible commitments”).

193. See Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724, 1745–54 (2001) [hereinafter Bernstein, *Private Commercial Law in the Cotton Industry*] (discussing how the cotton industry uses reputation and reputation-based non-legal sanctions); Lisa Bernstein, *Merchant Law in a Merchant Court: Rethinking the Code’s Search for Immanent Business Norms*, 144 U. PA. L. REV. 1765, 1771–77 (1996) [hereinafter Bernstein, *Merchant Law*] (analyzing “the operation of the NGFA system and compar[ing] the extent to which NGFA arbitrators applying the Association’s trade rules and courts applying the Code are willing to look to usage of trade, course of dealing, and course of performance in deciding cases”); Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115, 119–30 (1992) (discussing the New York Diamond Dealers Club and the club’s internal resolution mechanisms, including private arbitration).

diamonds, grain, feed, independent films, printing, binding, peanuts, rice, cotton, burlap, rubber, hay and tea.”¹⁹⁴

These specialized arbitral institutions, however, are often geared towards bolstering informal modes of enforcement. They supply expert decision makers who rely predominately on codified industry trade rules rather than publicly created rules (or industry norms or usages of trade).¹⁹⁵ Moreover, the parties rarely turn to public courts to enforce the awards that these tribunals grant; instead, they depend on extralegal sanctions, such as the threat of expulsion from the industry association.¹⁹⁶ Thus, even if parties occasionally need external enforcement help, they usually avoid the most formal modes of enforcement.¹⁹⁷

Because formal legal enforcement is largely irrelevant to contracts in this low uncertainty, high-scale domain, the risks of litigation opportunism are low, or even nonexistent. To the extent that parties might strategically game post-dispute informal enforcement, customized rules of procedure will not be helpful. When uncertainty begins to creep in, parties might deploy a few coarse, modular procedural customizations to opt out of courts and into

194. Lisa Bernstein, *Private Commercial Law*, in 3 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 108, 108 (Peter Newman ed., 1998) [hereinafter Bernstein, *Palgrave Dictionary Article on Private Commercial Law*].

195. Bernstein, *Merchant Law*, *supra* note 193, at 1777–82; Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 193, at 1731–34; LISA BERNSTEIN, THE NGFA ARBITRATION SYSTEM AT WORK 27–28 (2007), https://www.ngfa.org/wp-content/uploads/trade_rules/Arbitration-Study.pdf.

196. *See, e.g.*, Bernstein, *Palgrave Dictionary Article on Private Commercial Law*, *supra* note 194, at 109 (“In most industries, however, it is rarely necessary for a party to seek judicial enforcement of an award. Merchant tribunals are able to place their own pressures on the parties to comply promptly with their decisions.”); Bernstein, *Private Commercial Law in the Cotton Industry*, *supra* note 193, at 1737–38 (observing that it “is rarely necessary” to seek enforcement of awards in court; instead threat of expulsion is “usually sufficient to induce merchants to promptly comply with arbitration decisions unless they are bankrupt or in severe financial distress”).

197. *See* Christopher R. Drahozal, *Private Ordering and International Commercial Arbitration*, 113 PA. ST. L. REV. 1031, 1032–33 (2009) (recognizing that private ordering is not dichotomous and hybrid choices between purely formal adjudication in public courts and completely private adjudication in industry trade arbitrations is possible). For instance, Eric A. Feldman has described dispute resolution among Japanese merchants participating in the tuna auction at the Tokyo Central Wholesale Market. *See generally* Eric A. Feldman, *The Tuna Court: Law and Norms in the World’s Premier Fish Market*, 94 CALIF. L. REV. 313 (2006). Unlike the merchants studied by Professor Bernstein, the Tokyo tuna merchants resolve disputes in a government-sponsored, albeit highly specialized, court. *See id.* at 332–44.

arbitration or otherwise simplify choice of forum and choice of law issues for the few occasions when courts might be used.

This prediction may explain, or help to explain, the “procedural dog that has not barked” problem.¹⁹⁸ At first glance, existing studies on procedural contracting suggest that the practice is rare—at least outside of coarse, modular customizations.¹⁹⁹ This finding makes sense if the vast majority of contracts fall within the low uncertainty, high-scale domain. A random sampling would include a majority of contracts in this domain and suggest that procedural customizations are rare and minor. But this conclusion derives from transaction type, not contract design. Simply put, in this domain, because written contracts are not that important for any purpose, contract design, including procedural customization, is of little significance.

This story would explain Professor Weidemaier’s conclusions. Nearly 56% of the data set in Professor Weidemaier’s seminal study involves manufacturing or supply agreements, many (most) of which very likely fall within the low uncertainty, high-scale domain.²⁰⁰ Another 22% are distribution agreements, at least some of which also likely fall within this domain.²⁰¹ Accordingly, his conclusion that few parties customize procedure, although accurate, reflects only the reasonable practices of parties in the largest commercial party contracting domain. Because contract design plays a minimal role in the context where these contracting parties operate, the data does not necessarily reflect the frequency and value of procedural contracting in domains that experience higher levels of uncertainty and opportunism risk.

2. Low Uncertainty, Low Scale—Slightly More Risk of Litigation Opportunism

When scale declines and uncertainty stays low, parties are unable to benefit from standardized solutions because their contracting needs are somewhat unique. This happens in uncomplicated markets with relatively few participants. The low degree of uncertainty allows parties to create state-contingent, bespoke contracts.²⁰² Effectively, parties provide their own clarity about the terms of performance within the contract, limiting the need

198. *See supra* Part II.

199. *See supra* Part II.

200. Weidemaier, *supra* note 18, at 1908 & tbl.2.

201. *Id.*

202. Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 31.

for adjudicators to look beyond the four corners of the document.²⁰³ Because the substantive terms are relatively unambiguous, adjudicators are less likely to make mistakes; in turn, this dynamic curbs litigation opportunism. As a result, parties are unlikely to invest significant time or energy in procedural customizations.

Depending on the precise degree of uncertainty present, one might anticipate slightly more customization than in the low-uncertainty, high-scale quadrant. Specifically, this increase in customization likely arises at the margins where more formal enforcement may be necessary. Parties cannot depend on relational norms or industry-specific informal enforcement mechanisms (such as trade arbitration tribunals) to the same extent as in higher-scale markets. Although the work required to conduct a formal adjudication on the merits should remain reasonably uncomplicated, parties might still be able to game litigation based on the mechanics of a lawsuit, through use of a choice of forum or choice of law provision. Accordingly, one might expect to see more parties employing a few coarse, modular customizations of procedure to simplify these basic mechanics.

This prediction seems to map onto the existing evidence. For instance, Professor Scott discusses examples of patented electronic software licenses as falling within this low uncertainty, low-scale domain.²⁰⁴ As he points out, these “contract[s] can provide clear directions to a court of the context within which the specified uses of the licensed intellectual property are to be interpreted.”²⁰⁵ This happens through some combination of definitional clauses, purpose (or “whereas”) clauses, and appended examples provisions.²⁰⁶ Professor Scott does not explicitly examine the dispute resolution provisions in the two contracts he references, but both examples contain modular procedural customization, consistent with what the transactional space suggests is appropriate.

203. *See id.* at 31–32; *see also* Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 *YALE L.J.* 926, 952–55 (2010).

204. *See, e.g.*, Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 23–24 & nn.61–62 (citing and quoting Fountain Manufacturing Agreement Between Apple Computer Inc., and SCI Systems, Inc. (May 31, 1996), <http://contracts.onecle.com/apple/scis.mfg.1996.05.31.shtml> [<http://perma.cc/YD36-B6BS>] [hereinafter Fountain Manufacturing Agreement]) (citing Data Management Outsourcing Agreement Between Allstate Insurance Company and Axiom Corporation (Mar. 19, 1999), <http://contracts.onecle.com/axiom/allstate.outsource.1999.03.19.shtml> [<http://perma.cc/NAZ6-LDEA>] [hereinafter Data Management Outsourcing Agreement]).

205. *Id.*

206. *Id.*

In the 1996 Fountain Manufacturing Agreement Between Apple Computer Inc., and SCI Systems, Inc., the parties simply agreed to a forum (the Northern District of California) and a choice of law (California law).²⁰⁷ Similarly, in the 1999 Data Management Outsourcing Agreement Between Allstate Insurance Company and Acxiom Corporation, the parties agreed to an intricate series of informal dispute resolution escalation procedures.²⁰⁸ But these procedures merely aimed at bolstering informal enforcement, providing for resolution of “disputes arising in the ordinary course of the parties performance under this Agreement . . . by those directly involved.”²⁰⁹ Failing that, the contract provided for a staged escalation, keeping dispute resolution informal and trying to steer it out of the courts.²¹⁰ In the unlikely event that the need for formal enforcement might arise, the parties simply selected a forum and choice of law (federal or state court in Cook County, Illinois, and Illinois law)²¹¹ and effectuated this choice of forum by waiving any personal jurisdiction arguments.²¹²

As uncertainty edges slightly higher, some parties segment their potential disputes by carving out certain types of disputes for resolution in courts and other types for resolution in arbitration. For instance, as Part II noted, Professors O’Hara O’Connor and Drahozal studied at least three categories of contracts that fit squarely within this domain: technology contracts, CEO employment contracts, and franchise contracts.²¹³ These three categories of contracts address somewhat unique issues for the contracting parties. Although those issues largely involve risk, uncertainty can creep into the calculus. These contracts tend to provide for generic arbitration in most disputes, with little customization of arbitration procedures. This makes sense for the low uncertainty issues at stake. But these contracts also carefully select carve-outs for certain categories of disputes, particularly those related to information or intellectual property rights, where marginally greater degrees of uncertainty might be present.²¹⁴ Professors O’Hara O’Connor and Drahozal suggest that these carve-outs exist for a number of reasons, including that these subcategories of disputes may have

207. Fountain Manufacturing Agreement, *supra* note 204, ¶ 22.12.

208. Data Management Outsourcing Agreement, *supra* note 204, ¶ 21.1.

209. *Id.* ¶ 21.2.

210. *Id.* ¶ 21.3.

211. *Id.* ¶ 24.9.

212. *Id.*

213. *See supra* Part II.

214. *See* O’Hara O’Connor & Drahozal, *The Essential Role*, *supra* note 151, at 2182.

stakes that are sufficiently high to increase the harm of litigation opportunism—even if the probability of its occurrence remains low—and justify additional procedural customization.²¹⁵

To summarize, parties operating within contexts of low uncertainty and low scale can usually address the risk of litigation opportunism through the use of state-contingent contracts. Although parties might occasionally need to rely upon formal enforcement mechanisms, they can supply courts or general arbitration tribunals with sufficiently specified substantive terms to simplify adjudication of the substantive terms. To the extent that some residual risk of litigation opportunism exists, it tends to relate to the mechanics of lawsuits—such as concerns about where the lawsuits will be filed or what law will be applied—and parties make modular customizations to decide these issues. As uncertainty edges higher, some parties address the increasing hazard of litigation opportunism by making more granular, but still modular, carve-outs for differing categories of disputes.

3. High Uncertainty, High Scale—Moderate Risk of Litigation Opportunism

In contexts of high uncertainty and high scale, parties are more likely to encounter unanticipated contingencies than those conducted in a stable environment.²¹⁶ And parties struggle to identify obligations when those contingencies materialize. Accordingly, in this environment, contract designers increasingly use standards that take advantage of a decision maker's hindsight, which in turn allows for more flexibility in the specification of rights and obligations.²¹⁷ This drafting technique necessarily injects the possibility of ambiguity into determinations about performance and breach and subsequently increases the potential for harmful litigation opportunism.

215. *Id.* at 2182–84 (“The high stakes in at least some of the cases (such as trademark disputes for franchisors) also are important. Parties often prefer to have courts resolve ‘bet-the-company’ cases because the availability of appellate review reduces the risk of aberrational decisions.”) (footnotes omitted) (citing Christopher R. Drahozal & Quentin R. Wittrock, *Is There a Flight From Arbitration?*, 37 HOFSTRA L. REV. 71, 79–80 (2008); Drahozal & Ware, *Why Do Businesses*, *supra* note 98, at 455).

216. See Michael J. Leiblein, *The Choice of Organizational Governance Form and Performance: Predictions from Transaction Cost, Resource-Based, and Real Options Theories*, 29 J. MGMT. 937, 951–52 (2003).

217. See, e.g., Gilson, Sabel & Scott, *Text and Context*, *supra* note 20, at 39.

But in high-scale contexts, parties can ameliorate that risk by employing established industry norms *ex post* to help resolve that ambiguity. Because many contracting parties face the same (or similar) challenges, they can pool resources to establish collective understandings. Even if these understandings would be difficult for general courts or adjudicators to verify, parties operating in high-scale contexts can turn to decision makers—who may be part of specialized arbitration tribunals or courts—with an industry-rich understanding that is sufficient to convert observable phenomena into enforceable outcomes.²¹⁸ For instance, Professor Scott has argued that parties can turn to courts that develop experience and expertise by adjudicating a sufficiently large number of similar disputes.²¹⁹ Examples of such courts are Delaware Chancery courts, for corporate matters, and the Santa Clara County Superior Court, for industrial disputes arising in Silicon Valley.²²⁰

In terms of procedural customization, this means that parties in high uncertainty, high-scale environments are usually able to effectively combat litigation opportunism through simple modular customizations of procedure that opt into these specialized tribunals. Parties are unlikely to need (or want) much additional customization, since these specialized decision makers' primary advantage is their ability to leverage hindsight to achieve more accurate outcomes. If parties chose to impose complex procedural customization on disputes subject to these tribunals, they would run the risk of hamstringing these specialized adjudicators and undercutting their ability to extract value from vague standards included in the substantive terms of the contract.

Alternatively, parties in high-scale contexts may be able to forego most formal enforcement altogether. For example, Professor Lisa Bernstein has explored the ways that Midwestern original equipment manufacturers (“OEMs”) and their suppliers use long, detailed contracts to establish space for extra-legal modes of enforcement.²²¹ As she recognizes, these contracts “are artfully designed to create a framework for growing relational social capital and leveraging network governance.”²²²

218. *See, e.g.*, Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 32.

219. *Id.* at 32–34.

220. *See id.*

221. *See* Bernstein, *Beyond Relational Contracts*, *supra* note 56, at 562.

222. *Id.* at 563.

In one sense, OEM contracts are relatively predictable, as they often involve the supply of discrete and already-existing goods.²²³ But the long-term nature of these contracts, “the fact that buyers expect strict compliance regarding quality, [the need for] on time delivery, and a host of logistics-related requirements” (including the interdependency of buyers on multiple suppliers) creates high degrees of uncertainty.²²⁴ Professor Bernstein concludes that transacting parties have been able to confront this uncertainty with only minimal reliance on the legal system, in large part because the network in which they function serves as a contract governance mechanism.²²⁵ Practically, parties can study patterns of past alliances and connections in the network relevant to a particular deal thereby mitigating opportunism through reputation.²²⁶ Although there are high levels of uncertainty, parties are able to avoid most litigation or dispute opportunism through informal enforcement processes. Therefore, they need not turn to much procedural customization.²²⁷

In high uncertainty, high-scale environments, parties can primarily rely on industry-provided solutions, including specialized decision makers or

223. Professor Bernstein notes that many OEM relationships, in the modern world, also involve elements of innovation. *Id.* at 610. In fact, “tapping supplier innovation . . . is the second-highest [procurement] priority, and includes actively attracting and developing the most innovative suppliers to help generate new ideas.” *Id.* (quoting Patrick Connaughton & Christopher S. Sawchuck, *2014 Procurement Agenda: Rethinking How Procurement Defines Its Value, Balances Risk and Gets the Most from Technology Investments*, HACKETT GRP. (Jan. 2014), http://images.insights.thehackettgroup.com/Web/TheHackettGroupInc/%7Bf5b5061d-cadb-44dc-9b1c-6543faebc20c%7D_HCKT-2014-Procurement-Agenda.pdf?elq_track=true). To the extent that OEM relationships spin into contracts for innovation, they may more aptly be considered collaborative innovation contracts and fall within the high uncertainty, low scale domain discussed in the following section.

224. *Id.* at 578.

225. *See id.* at 563–65.

226. David T. Robinson & Toby E. Stuart, *Network Effects in the Governance of Strategic Alliances*, 23 J.L., ECON., & ORG. 242, 244 (2007).

227. For instance, in the Harley-Davidson Master Supply Agreement (2015), Purchase Order Terms and Conditions Module (one of the contracts that Professor Bernstein evaluates in some detail), Harley-Davidson does minimal procedural customization, and all of it is modular in nature. Harley-Davidson selects Wisconsin law (and opts out of the Convention on the International Sale of Goods). *Purchase Order Terms and Conditions*, HARLEY-DAVIDSON SUPPLIER NETWORK, ¶ 21(b), https://www.h-dsn.com/genbus/po_tracking.jsp (last visited Apr. 7, 2020). It selects Milwaukee County Circuit Court for the State of Wisconsin or the United States District Court for the Eastern District of Wisconsin as the forum. *Id.* ¶ 21(d). The only other customizations bolster the choice of forum. For instance, Harley-Davidson includes a waiver of objections to personal jurisdiction. *Id.*

network governance that enhances informal enforcement mechanisms, to confront litigation opportunism. Existing procedural customization practices tend to direct disputes to specialized decision makers through choice of forum clauses, including arbitration clauses. In circumstances where there might be various categories of disputes that could benefit from differential treatment, parties can use more atomistic carve-outs to modify their dispute resolution processes. Finally, in arbitration, parties still might tailor procedure to a certain degree, especially when it comes to decision makers' qualifications or expertise.

4. High Uncertainty, Low Scale—High Risks of Litigation Opportunism

Parties are most likely to benefit from (and thus most likely to seek) bespoke procedural systems in innovation-oriented contracts, where uncertainty is high and scale is low.²²⁸ These environments include co- or joint-development contracts, research and development collaborations, OEM contracts that include going improvement and development provisions, or new services innovations.²²⁹ In such environments, parties cannot hope to specify all (or even a meaningful set of) potential circumstances in which the contract might be performed, or the actions the parties might take. Moreover, the changes caused by persistent innovation and the limited number of market actors undermine the capacity of any market or industry to develop shared understandings. As a result, frequent, and sometimes even good-faith, disagreements occur about what constitutes proper performance or an appropriate response to conditions that arise ex post.

This pervasive uncertainty means that parties often contract to provide a framework for their collaboration, rather than to guarantee a particular outcome. In these contracts for innovation, formal enforcement plays an important and focused role. For instance, Professors Hadfield and Bozovic describe formal enforcement mechanisms as “scaffolding” for informal enforcement norms.²³⁰ Professors Gilson, Sabel, and Scott argue for the

228. A distinction should be made between contracts for innovation and contracts about innovation. Some contracts, in other words, provide the framework within which innovation takes place, while other contracts are more conventional and address the protection, transfer, licensing, or other use of extra-contractual innovations.

229. See Hadfield & Bozovic, *supra* note 22, at 992–95.

230. *Id.* at 988 (“In our framework, formal contracting provides essential scaffolding to support the beliefs and strategies that make informal means of enforcement such as reputation and the threat of termination effective.”).

imposition of “low-powered” sanctions in the event of a breach of the formal aspects of a collaborative contract.²³¹ Low-powered enforcement imposes formal remedies for “red-faced” violations of the agreement to provide a prioritized opportunity, but it does not impose sanctions for failure to reach particular outcomes.²³²

Both approaches view trust as emerging endogenously from the parties’ relationship, with formal enforcement provisions playing a limited but critical role by requiring certain information sharing. Professors Bozovic and Hadfield postulate that trust grows as the parties proceed with the relationship and continually refer back to the documents that created the relationship to evaluate one another’s performance.²³³ Professors Gilson, Sabel, and Scott contend that informal constraints become effective as the collaboration progresses and relevant metrics of performance become more observable.²³⁴ Additionally, the continuing revelation of information and ongoing relationship increases switching costs, making it more likely that the parties will informally solve problems to maintain the collaboration.²³⁵

In collaborative contracts, legal enforcement should (and does) take a back seat to informal alternatives, but it remains foundational to the functioning of the alliance. Default procedural rules frequently fail to satisfy the parties’ objectives, given the unique needs of both sanctioning some specific behavior while also encouraging the development of informal norms. Because only a limited number of parties have similar needs, courts struggle to supply accurate substantive terms *ex post*, and open-ended public procedural rules, which give tremendous discretion to judges, magnify this shortcoming.²³⁶

231. See, e.g., Gilson, Sabel & Scott, *Braiding*, *supra* note 37, at 1427–31.

232. See *id.* at 1417.

233. See Hadfield & Bozovic, *supra* note 22, at 988 (“In our framework, formal contracting provides essential scaffolding to support the beliefs and strategies that make informal means of enforcement such as reputation and the threat of termination effective.”).

234. See Gilson, Sabel & Scott, *Braiding*, *supra* note 37, at 1384 (“We focus on the fact that contracting parties can and do agree on formal contracts for exchanging information about the progress and prospects of their joint activities, and that these same information exchanges provide the foundation for raising the existing level of trust. It is this information-sharing regime that braids the formal and informal elements of the contract, endogenizes trust, and thereby supports the informal enforcement of the parties’ substantive performance.”).

235. See *id.*

236. See, e.g., Blair, *Promise and Peril*, *supra* note 14, at 800 (“[T]he reformers opted to entrust judges with broad discretion to put the rules of procedure into action in individual

Procedure, in other words, amplifies worries that formal enforcement will crowd out the development of essential informal norms. It makes sense, then, that parties confronting the dilemmas of contracting in environments of high uncertainty and low scale would rely on bespoke procedural regimes to help resolve disputes reliably and at an acceptable cost.²³⁷ This reliance, in fact, is precisely what researchers see in practice. As Part II-C observes, parties to alliance agreements regularly create intricate procedural regimes.²³⁸ These complex, multi-tiered dispute resolution regimes are highly customized to augment and reinforce other substantive governance mechanisms without crowding out the growth of informal norms.²³⁹

For instance, in a recent alliance agreement between Frequency Therapeutics, Inc. and Astellas Pharma, Inc., the parties established a framework for the development, manufacture, and commercialization of a new regenerative therapy for hearing loss.²⁴⁰ Their dispute resolution system distributes different conflicts to different parties and decision makers, with most common disputes regarding details of the collaboration first being sent to a Joint Steering Committee (“JSC”).²⁴¹ If a routine disagreement cannot be resolved by the JSC, it gets escalated to the executive officers, who then attempt to resolve it informally.²⁴² Failing such informal resolution, a standard dispute proceeds to a binding arbitration that

cases.”) (footnote omitted). *See generally* Amalia D. Kessler, *Our Inquisitorial Tradition: Equity Procedure, Due Process, and the Search for an Alternative to the Adversarial*, 90 CORNELL L. REV. 1181 (2005) (noting how the Rules retrieved equity as a source of procedural discretion); Thomas O. Main, *Traditional Equity and Contemporary Procedure*, 78 WASH. L. REV. 429 (2003) (arguing for broad use of equitable discretion).

237. *See generally* Gilson, Sabel & Scott, *Contracting for Innovation*, *supra* note 37 (advancing a similar argument with respect to the design of substantive terms).

238. *See supra* Section II.C.

239. Jennejohn, *The Private Order*, *supra* note 15, at 362 (“Establishing a constellation of enforcement institutions appears to be a common strategy among collaborations.”).

240. *See* License and Collaboration Agreement by and Between Frequency Therapeutics, Inc. and Astellas Pharma, Inc., ¶ 1.95 (July 16, 2019), <https://www.sec.gov/Archives/edgar/data/1703647/000119312519239976/d72917dex1012.htm> [hereinafter License and Collaboration Agreement]; *see also* GlobalData Healthcare, *Astellas Pharma and Frequency Therapeutics Collaborate on Hearing Loss Therapy*, VERDICT MED. DEVICES (July 31, 2019), <https://www.medicaldevice-network.com/comment/fx-322-hearing-loss-therapy/>.

241. *See* License and Collaboration Agreement, *supra* note 240, ¶¶ 3.02(f), 3.09.

242. *Id.* ¶¶ 3.09, 3.10.

uses a simplified baseball procedure and severely constrains opportunities to gather and produce evidence.²⁴³

In contrast, more serious disputes about alleged material breaches, failures of payments, or the validity of agreements do not go through the JSC at all. The executive officers may attempt to resolve such disputes informally, but should those efforts fail, these disputes proceed to conventional arbitration before a three-arbitrator tribunal operating under the rules and auspices of the International Chamber of Commerce.²⁴⁴ If these more serious disputes involve scientific or technical matters, the arbitrators must have industry expertise.²⁴⁵

Like the serious disputes discussed above, those involving intellectual property rights also bypass the JSC. Executive officers may attempt to resolve these disputes, but those that evade internal resolution are presented to a court or patent office of a country where the patent was issued, or where the patent application was filed.²⁴⁶ Finally, either party may file a claim in a U.S. court to seek injunctive relief to protect other intellectual property rights.²⁴⁷

The Frequency Therapeutics, Inc. and Astellas Pharma, Inc. alliance agreement establishes an intricate system of informal and formal dispute resolution that sorts potential disputes into different categories before filtering them through individuated layers of dispute resolution. The system encourages informal resolution of routine disagreements by providing multiple opportunities that exist outside formal mechanisms. This fosters trust by focusing on communication and information sharing, and thus reinforcing the substantive goals of the collaboration. In the somewhat unlikely event that routine disputes are not resolved informally, the simplified baseball arbitration procedure helps protect the cooperative venture from being derailed by costly and time-consuming post-dispute opportunism related to minor disagreements. The agreement also recognizes, however, that more serious disputes require different mechanisms and directs them to decision makers who have relevant expertise or injunctive powers.

A collaboration agreement between Vir Biotechnology, Inc. and Alnylam Pharmaceuticals, Inc. for the therapeutic for the treatment of

243. *Id.* ¶ 16.01(d).

244. *Id.* ¶ 16.01(c).

245. *Id.*

246. *Id.* ¶ 16.01(e).

247. *Id.* ¶ 16.01(c).

chronic Hepatitis B provides a similar example.²⁴⁸ This agreement similarly distributes common disputes to executive officers. It then trifurcates where disputes next go for resolution. Common categories of disputes are resolved by expedited baseball arbitration.²⁴⁹ Notably, this expedited process limits discovery and relies on the parties' appointed representative experts, who, in turn, select a neutral expert to serve as the arbitrator.²⁵⁰ While the parties have no direct contact with the neutral expert arbitrator, the arbitrator may consult with the parties' appointed experts.²⁵¹ With respect to certain "excluded claims" related to intellectual property rights, parties must go to a court of competent jurisdiction where the right arose, was created, or can be legally regulated.²⁵² For other serious disputes, the contract then allows parties to choose between litigating in a court of competent jurisdiction or arbitrating.²⁵³ If the parties opt for arbitration, the contract provides details about the arbitral process, including the limited scope of discovery.²⁵⁴

Like the Frequency Therapeutics alliance agreement, the Vir Biotechnology agreement sorts potential disputes into different categories. This has the particular benefit of sending most minor disputes through an expedited baseball arbitration. By removing most of the discovery process, limiting presentation of evidence, and streamlining adjudication, the parties to the Vir Biotechnology agreement have cabined most post-dispute litigation opportunism while still allowing for the streamlined resolution of nettlesome disagreements.

To summarize, in contexts of high uncertainty but low scale, parties already invest more resources *ex ante* to draft complicated, substantive contracts that are designed to foster and develop trust over time. These parties employ careful and thoughtful procedural customizations to ensure that enforcement mechanisms support their substantive goals without crowding out the development of informal, relational norms.

248. *See* Collaboration and License Agreement By and Among Vir Biotechnology, Inc. and Alnylam Pharmaceuticals, Inc. (Oct. 16, 2017), <https://www.sec.gov/Archives/edgar/data/1706431/000119312519236592/d755217dex1017.htm>.

249. *See id.* ¶ 13.3.

250. *Id.* ¶ 13.2(a)–(c).

251. *See id.* ¶ 13.3.

252. *See id.* ¶ 13.2(f).

253. *Id.* ¶¶ 13.1, 13.2.

254. *See id.* ¶ 13.2(a)–(e).

Conclusion

Despite a vast contract theory literature, scholars are only just scratching the surface of understanding how parties design their contracts in the real world.²⁵⁵ This shortfall is particularly true of procedural customizations. Contrary to early commentators' estimates, parties sometimes engage in a diverse range of procedural customization. The challenge, though, has been identifying and explaining the patterns of *ex ante* procedural contracting.

This Article has argued that the first step toward understanding the ways that transactional designers harness the potential of procedural autonomy is to recognize that procedural customization functions best to offset litigation opportunism. By systematically considering the way various forms of procedural customization function to limit or eliminate litigation opportunism, this Article has taken an important step in helping identify the circumstances when customizations of procedure can be valuable as additional governance tools.

Utilizing this Article's typology of procedural innovation, which considered the degree of environmental and behavioral uncertainty present and the frequency with which other similar parties contract in the same domain, commentators can more easily predict the degree of procedural modification in contracts.

In environments of low uncertainty but high scale, parties have little need for formal, detailed contracts, structuring their relationships instead through relational norms. Because written contracts do modest work and parties place little reliance on formal enforcement, contract designers need not invest much in procedural customizations. At most, designers in this domain might make a few coarse, modular customizations aimed at simplifying choice of forum and law decisions, in the rare event business solutions break down and the parties turn to courts or arbitrators. As scale drops, parties in low uncertainty environments can no longer rely on standardized solutions, but they can draft substantively state-contingent contracts at reasonably low costs. This customization keeps the risk of litigation opportunism in check. Consequently, little need for precise procedural tailoring exists. Parties can, instead, mostly rely on the default rules of procedure. To the extent that any customization makes cost-effective sense, that customization tends to be coarse and simple, aimed at streamlining adjudication and curbing extreme litigation abuses.

255. See Scott, *Contract Design and the Shading Problem*, *supra* note 32, at 2–3.

When uncertainty increases, parties in a high-scale market tend to be able to address future contingencies and their inherent risks by choosing decision makers with specialized expertise or relying on network governance—an interconnected web of relationships with similarly situated parties. In these high-uncertainty but high-scale environments, parties rely on more detailed and transactionally particularized contracts but engage in relatively limited procedural customization. To the extent that such customization exists, it tends to be modular, often opting out of courts and into arbitration. Given the importance of the decision maker's expertise, however, parties more frequently tweak the details of the arbitral process, including arbitrator expertise, in order to assure that a decision maker has relevant industry expertise and sensitivity to the parties' circumstances. Parties also sometimes make more atomistic carve-outs for certain categories of disputes.

In contrast, as uncertainty rises but scale declines—that is, as the business environment becomes more innovative—parties cannot confront increasing exchange hazards through common industry norms. Meanwhile, parties also struggle to specify obligations and rights *ex ante*. These actors rely more heavily on lawyers and contracts to supply substantive obligations, but those obligations are often framed vaguely, opening the door to litigation opportunism. To confront that opportunism, parties invest in greater tailoring of the procedural mechanisms that reinforce, maintain, and decide the integrity of those obligations. The degree of that tailoring roughly correlates to the degree of uncertainty and scale at issue.

While untested in its own right, conclusions predicted by this four-domain typology seem to correspond with most of the empirical data scholars have about procedural contracting. But perhaps the most significant advance this Article proposes is providing a roadmap for future, more particularized, empirical work to test the key hypothesis that procedural innovation will vary in relation to the mix of uncertainty and market scale of a given commercial transaction.