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“Terms of Engagement”

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After representatives from the United States and North Vietnam arrived in Paris to negotiate an end the Vietnam War, a long time was spent on preliminaries. They had to settle on the rules that would govern their negotiations. The first stumbling block consumed many weeks. It was the shape of the bargaining table. Where representatives of the South Vietnamese government and the communist-led National Liberation Front sat would affect the role each would play in the negotiations and this would in turn affect the final bargain.

What holds for diplomats holds for all negotiators, including commercial actors in the marketplace. The environment in which parties negotiate matters, and contract law, in conjunction with commercial norms, contributes to the bargaining environment. The substantive default rules of contract law set the stage for the bargaining that follows. So too do the various background rules that establish the obligations each party owes the other about sharing information. In addition, sophisticated parties enter into negotiations with a sense of the contours of the usual arrangements in their own industries. These too give decisive shape to the bargain.¹

¹ Harry A. Bigelow Distinguished Service Professor, University of Chicago Law School. This Essay owes much to and tries to build upon Lisa Bernstein’s recent groundbreaking work on supplier networks. I received valuable comments from Scott Baker, George Wu, and the participants at the Columbia University Law and Economics Workshop. Brent Yarnell provided most useful research assistance. The Frank Greenberg Fund and the John M. Olin Fund provided research support.

¹ To give one example of how such expectations can trump even apparently mandatory legal rules, consider the provision of the Bankruptcy Code that allows for the payment of the fees of the indenture trustee only if she makes a “substantial contribution” to the case. 11 U.S.C. §503(b)(5). When the parties present a plan that includes such a fee and no one objects, no inquiry is made.
As the negotiations between the United States and Vietnam illustrate, the parties can also shape the bargaining environment themselves. An automobile manufacturer has terms and conditions that form the starting place for bargaining between it and its supplier. Toyota and a supplier are free to enter into a contract of any duration they choose, but the starting place is one in which each has the option to cancel on six-months’ notice. In addition, the course of dealing between the parties themselves establishes the parameters of their subsequent negotiations. When an unexpected event appears and the relationship needs to be reforged, past practice affects the terms of bargaining, even if at the time there is no legally enforceable contract between the parties.

This review essay takes stock of what is known about terms of engagement. It focuses first on the legal rules that help create the environment in which the parties bargain with each other. It goes on to explore how parties create their own terms of engagement.

I. Default Terms and Terms of Engagement

In many market transactions, bargaining rules have little effect on the final contract. A buyer wants a standardized part, and a supplier wants to sell it. Both are rational. Both expect the sale to take place at the market price under terms that maximize the gains from trade. The bargaining environment is not complicated, and contract law works best when it provides background rules into whether the indenture trustee’s contribution was substantial. As it happens, when parties negotiate plans of reorganization these fees are never on the table. They routinely paid without regard to whether the indenture trustee did anything of note. Junior associates sometimes learn about this convention through a hazing ritual. Aspiring young bankruptcy lawyers are instructed to go to plan negotiations and to insist that the indenture trustee has not made a substantial contribution to the case. It is funny, at least to seasoned reorganization lawyers, in the same way it amuses experienced cooks in France to send new apprentices on their first day to retrieve soufflé weights lent to another restaurant.

2 Toyota Motor Engineering & Manufacturing North America, Inc. Terms and Conditions §5.8(a) & (b).
that reduce the cost of contracting. Contract law provides parties with the rules governing warranties and risk of loss for which the parties would bargain if they spent the time and the money to do so. The parties know the terms they want. When these are the same that the law provides, the contracting process is easy. Even when they are not, they can draw upon the customs of the trade or their own experiences to put in place those that suit them.

Changing the substantive background rule is often not hard. Ordinary contract law awards those who ship goods the reasonably foreseeable costs of delay when a carrier fails to deliver goods on time, but carriers almost always disclaim such liability. Given that these disclaimers are universal and operate against even the most sophisticated parties, they likely make sense, and the cost of making them is trivial. We might be better off with a different default, but it likely makes little difference.

Matters become more complicated when the parties themselves can tell whether promises are kept, but courts cannot. When they bargain with each other, such parties will attempt to mitigate the problems that arise from this observable, but nonverifiable information. Given that it is in their mutual interest to solve such problems, they will try to do so, regardless of the bargaining environment and the various default rules they find there. If the bargaining costs are small enough, the parties can find a way to construct a sensible contractual mechanism, one that ensures that the parties have the appropriate incentives throughout the course of the contract. Here again, the terms of engagement may not matter much.

But bargaining is never completely frictionless, even when the actors are sophisticated and the stakes are relatively large. Consider the wholesale market for used cars. Cars are put up for auction and only sophisticated commercial actors participate. The rules are constant across auctioneers. Nevertheless, it matters even who the auctioneers are. Some are better than others. Change almost anything, and the bargains struck will change as well. And there are many markets where there is a great deal of friction and here the rules of engagement matter a lot. Many things affect the bargaining environment. In this Essay, the focus is on how legal rules affect the environment and how the parties themselves reshape them.

The effect background legal rules can have on the bargaining environment is easy to illustrate by positing the presence of private information. Default rules can, for example, give parties with private information the incentive to disclose it during the course of bargaining. To take a standard illustration, those who ship goods that will suffer high damages if there is a delay can be given an incentive to disclose their type if, instead of expectations damages, the law places a cap on

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6 From the perspective of the auction-house, the better auctioneers are the ones who are more likely to attract a bid that exceeds the reservation price, thereby producing a sale (and therefore a commission and revenue for the auction house). Nicola Lacetera, Bradley J. Larsen, Devin G. Pope & Justin R. Sydnor, Bid Takers or Market Makers? The Effect of Auctioneers on Auction Outcomes, 8 American Economic Journal: Microeconomics 195 (No. 4, Nov. 2016) (examining identity of auctioneer affects whether the probability that a given auction will result in a sale as well as secondary performance metrics such as price (conditional on sale), high bid (not conditional on sale), and speed of sale).

7 Of course, the legal rules create an environment in which formal and informal methods of enforcement interact with each other. For the leading work here, see 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). This “braided” relationship between the two is one of the things this review essay attempts to keep in focus.
damages. Once their type is disclosed, the carrier is positioned not merely to charge more, but also to take extra precautions when the costs of delay are particularly high.

But it is easy to make too much of such examples. The role of this sort of private information is easy to overstate in commercial relationships of any duration. Consider explicitly the question of shipping delays and the costs it can impose on the parties. The rise of just-in-time inventory makes it is a salient issue that is made an explicit subject of negotiation in the mine-run of commercial relationships. There is no need for a background rule of contract damages to force the issue out into the open.

Mandatory contracts terms are most likely to affect the bargaining environment when there is private information and contract damages are less than fully compensatory. The ban on supercompensatory damages is the usual example. A widow wants to build a monument to her late husband. Her own health is poor, and her children are untrustworthy. If she dies before the monument is finished, there is no guarantee that the children will keep their promise to honor their father with this monument. Being able to recover expectation damages in the event that the monument builder does not perform on time will not put the widow in the same position she would be in if the monument were completed on time. She is not indifferent between money damages as assessed by the court and timely performance, given the risk of delay and the possibility she will die before the monument is finished.

For this reason, she wants to find a monument builder who is reliable. Whether a monument builder is reliable is private information known only to the monument builder herself. Every builder will say that she is reliable, but only some are and they know who they are. If the background legal rule allowed parties to set super-compensatory damages, the widow would be able to bargain

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10 These facts are loosely based on Muldoon v. Lynch, 6 P. 417 (Cal. 1885).
in a way that screened out unreliable builders. She could offer to pay more than the market price, but insist on super-compensatory damages. By doing this she would separate the highly reliable monument builders from the low types. Only highly reliable bidders could afford to bid.

There is, of course, a potential inefficiency in such contracts. When the damages are set above actual damages, the monument builder may complete the monument even when it is not in the mutual interest of her and the widow. But this inefficiency must be weighed against the inefficiency of having an unreliable builder fail to complete the job before the widow dies. Whether this is possible to screen out unreliable builders in the bargaining process turns on the background rules that contract law puts in place.

In addition to the way that substantive contract rules can affect bargaining, there are, of course, the more direct rules that guide the conduct of the parties during the negotiations themselves. Most salient in the Anglo-American law of contract is the absence of a duty to disclose. Parties do not have to reveal material information when they are negotiating with a stranger at arms’ length. If bargaining were costless, the absence of such a duty to disclose would not matter. A party could always ask the other, “Please tell me any information you would think important if you were in my shoes.”

But, of course, bargaining is not costless. Among other things, legal rules interact with various background norms. Someone who asks too many questions and pushes for too much disclosure may reveal private information about herself. Someone who raises issues likely to arise only in litigation may lead others to believe that she is likely to be litigious and therefore an unattractive contracting opposite.

Moreover, mandatory disclosure obligations can bring benefits.\textsuperscript{12} Information is a public good. Once it exists, everyone is better off if it is disseminated. Disclosure rules may discourage people from gathering information, but this is not necessarily a bad thing. There is little value, for example, in spending hundreds of millions transmitting information about option prices a few milliseconds faster than anyone else.\textsuperscript{13} There are few social benefits from such investments in information. Without a duty to disclose, parties to a trade may spend money trying to learn about the outcome of peace negotiations a few minutes earlier on a Sunday morning than anyone else.\textsuperscript{14} Of course, disclosure duties may deter parties from investing resources in gathering information that is socially useful. A Chippendale table may otherwise remain in a garage rather than a museum. The point here is only that the disclosure rules put in place affect the environment in which parties negotiate and this in turn affects the bargains that are actually struck.

Other rules directly govern the negotiation process itself. Consider, for example, the rule of the forthright negotiator.\textsuperscript{15} Two parties are bargaining with one another, and one is aware that the contract they have been drafting is ambiguous and also knows that the other party is unaware of the ambiguity. The rule of the forthright negotiator provides that in such cases the ambiguity is resolved in favor of the party who was unaware of it. Such a rule alters the


\textsuperscript{14} Such were the facts of Laidlaw v. Organ, 15 U.S. 178 (1817).

\textsuperscript{15} United Rentals, Inc. v. RAM Holdings, Inc., 937 A.2d 810 (Del. Ch. 2007).
bargaining environment. The rule gives the party with knowledge of an ambiguity an incentive to reveal it. The result may be bargains with fewer ambiguities. The rule tends to increase the flow of information between the parties. Of course, such rules have downsides. Among other things, they invite litigation about what parties were aware of what and when.

Discrete areas of the law create their own distinctive bargaining environments. Labor law obliges parties to negotiate about some issues (such as wages and hours), but not others (such as the employer’s overall financial health).\(^{16}\) In Chapter 11, only the debtor is allowed to propose a plan of reorganization at the start of the case, and no one can solicit a rejection or acceptance of a plan unless the court has first issued a disclosure statement.\(^{17}\)

When one party sues another, settlement negotiations routinely take place, and courts have control over how these are structured. A court can, for example, require mediation. As part of the mediation, it can impose various requirements, such requiring the physical presence at the mediation of someone on each side who is empowered to bind it to a settlement on the spot. Imposing such conditions also shapes the bargaining environment. The dynamics of bargaining are different if a deal can be closed without either party needing to leave the room. As a general matter, however, Anglo-American law leaves the bargaining environment largely unregulated.

Formal rules might play a large role in this environment, but, as a general matter, they do not. A fixed rule, for example, that enforced only written contracts that were executed with sealing wax has the nice property that parties would never have to worry about entering into contracts unwittingly. Parties would know that there were no contractual obligations between them until the sealing wax came out.

\(^{16}\) See, e.g., N. L. R. B. v. Wooster Div. of Borg-Warner Corp., 356 U.S. 342, 349, (1958) (firm and union must bargain with each other in good faith with respect to ‘wages, hours, and other terms and conditions of employment; as to other matters, however, each party is free to bargain or not).

\(^{17}\) It should be noted, however, that the requirement of that a disclosure statement be approved before solicitation is often honored in the breach. See, e.g., In re Indianapolis Downs, LLC, 486 Bankr. 286, 296 (Bankr. D. Del. 2013).
There are many disadvantages to such a regime. Parties typically want to be able to commit themselves much more easily than such a rule permits. But such a rule would create a bargaining environment in which suggestions and ideas might flow much more readily. Parties could make proposals and explore undertakings without fearing that merely talking about them might lead to legal obligations at some later time. The possibility of such rules, however costly they might be, illustrates the way in which legal rules affects the bargaining environment and how that in turn might affect ultimate bargains.

A common law rule that does work in this fashion is the one that prevents a contract from being formed through silence.\textsuperscript{18} This rule gives parties greater confidence that they can enter into negotiations or decline to enter into them without fear of being tagged with contractual liability.\textsuperscript{19} In the absence of some affirmative action on their part, no contract is formed. None of these rules, of course, comes without cost. Among other things, the need to obtain explicit agreement makes it harder to solve the collective action problem that arises when there are many parties to the same contract. Some have little incentive to participate in negotiations given that the benefits of their efforts will go to others.

There are ways to bind dissenters in this environment, but the background rule is generally the same as the common law rule. Third-party releases in Chapter 11 reorganization plans have to confront this difficulty. To forge a consensus, it might be desirable for parties to release each other from liability and such releases might enjoy the support of a supermajority, but it may be

\textsuperscript{18} The rule, however, is somewhat complicated by the idea that the previous dealings of the parties might give the offeree the duty to speak. In the language of the Restatement (Second) of Contracts §69, the test is whether “the offeree has given the offeror reason to understand that the silence or inaction is intended by the offeree as a manifestation of assent.”

\textsuperscript{19} Karlin v. Avis, 457 F.2d 57, 62 (2d Cir. 1972) (“An offeror has no power to transform an offeree’s silence into acceptance when the offeree does not intend to accept the offer.”).
necessary to obtain actual consent from each individual bondholder might make such releases impracticable.\textsuperscript{20}

Parties can solve this problem of gaining group consensus to some extent with collective action clauses in their contracts. These allow parties to give an agent the ability to act on behalf of all with the consent of only a majority or a supermajority. But such clauses are themselves are not always enforceable. The Trust Indenture Act, by limiting the enforceability of such clauses, has the effect of making the bankruptcy forum the bargaining environment with respect to the payment of principal and interest.\textsuperscript{21}

Even if bargaining were costless, background rules matter because of the inferences that will be drawn when someone needs to take an affirmative action to put a subject on the bargaining table. Assume that goods vary in quality, but only the sellers know the quality of their own goods. At the same time, buyers can invest in precautions and reduce the chance that the goods will break. Both parties can tell whether such precautions are taken, but the judge cannot. The judge can observe only whether the goods work or not. Assume finally that the law provides for a strong warranty, so strong that a buyer who enjoys such a warranty has no incentive to take precautions against the machine breaking down. Parties can opt for a lesser warranty if they want, but the strong warranty is the starting place for negotiations.

In such a bargaining environment, there is a chance that parties will enter into contracts in which the goods are sold with a strong warranty, even though they would all be better off if the warranty were weaker. In such an equilibrium, the buyer has no incentive to take care. It is possible that no individual seller will

\textsuperscript{20} For an example of a case in which the common law doctrine against drawing inferences from silence might have had this effect, see In re SunEdison, Inc., No. 16-10992 (Bankr. S.D.N.Y. Nov. 8, 2017).

\textsuperscript{21} Mark J. Roe, The Voting Prohibition in Bond Workouts, 97 Yale L.J. 232 (1987). For some, the Trust Indenture Act forces bankruptcies that are unnecessary, but this is not a by-product of the legislation, but rather its intention. Its drafters did not want to prohibit workouts. Instead, they wanted to ensure that negotiations among bondholders to take place under the supervision of the bankruptcy court.
suggest writing a contract with a weaker warranty. Such a contract would give the buyer an incentive to take care, but at the same time the sellers that most want to bargain about the issue are the ones whose goods are low quality. Hence, no individual seller wants to raise the issue out of fear that, by raising it, buyers will infer it is low quality.

To be sure, it is possible that it might also be an equilibrium for everyone to agree to sell the goods at a lower price with a weaker warranty. In such an equilibrium, all the buyers have an incentive to take care. This is, by assumption, desirable, even though it has the effect of benefitting the low-quality sellers at the expense of the high-quality ones. But once parties are stuck in a bad equilibrium, parties might remain there until a norm entrepreneur comes along and shifts everyone to the good equilibrium.\(^{22}\) Trade associations can perform this role.\(^{23}\)

A particularly salient example of this sort of dynamic arises in the context of pre-nuptial agreements. The background rules governing divorce might not be optimal, but neither prospective spouse can propose a pre-nuptial agreement without suggesting to the other doubts about whether the marriage will survive. Those with the fewest doubts remain silent. Those with the next fewest doubts choose to remain silent as well and so forth. No one speaks, and there are no prenuptial agreements, even though everyone as a group would be better off if they were. Opting out of a legal rule may not be possible without a norm shift.

Of course, if the background default rule is sufficiently bad, there are incentives for norm entrepreneurs to enter the picture. This has been the case in recent years with orthodox Jewish marriages. The equilibrium without a prenuptial agreement is particularly unattractive. A divorce becomes effective only if the husband grants consent, and rabbinical tribunals lack the ability they once enjoyed to induce such consents. The result is an asymmetry that gives the


husband leverage over such issues as child custody and child support, an equilibrium that is not in the joint ex ante interests of the parties. This is the agunah problem.\textsuperscript{24}

Changes in the bargaining environment that allow shifts from a bad to a good equilibrium might be possible only with the intervention of a norm entrepreneur. In the case of orthodox marriages, the norm entrepreneur was a group of rabbis. This group endorsed a halachic prenuptial agreement that is consistent with Jewish law. It takes the form of an arbitration agreement that is enforceable in state courts.\textsuperscript{25} The group’s endorsement and the efforts of others changed the social meaning of the prenuptial agreement. Instead of raising doubts about the longevity of the prospective marriage, it signaled the marriage as a partnership between equals. The signing of this prenuptial agreement is now sometimes even part of the part of the marriage celebration itself. Witnessing the signing of a prenuptial agreement becomes, instead of an unpleasant technicality, an honor bestowed on one or more of the wedding guests.

II. Customized Terms of Engagement

A. Postcontractual negotiations

Parties often reshape the background rules and craft their own. A small company is developing a new drug. It needs financing and begins merger negotiations with a larger company and at the same time negotiates interim financing. At this point, the small drug company is free to license the drug to the larger company under the ordinary background rules that govern negotiations between with any third parties. But the bargaining environment changes if it agrees, as part of getting the interim financing, that, should the merger negotiations fail, it will each bargain in good faith with the larger company over a license of the drug. Once it agrees to negotiate in good faith using the a two-page term sheet as a template, the small company is in an altogether different


\textsuperscript{25} See Melanie Grayce West, For Orthodox Jews, a Different Kind of Prenup, Wall St. J., April 5, 2016.
bargaining environment. The parties might discover some impass over a particular term, but the small company is no longer free to walk away from the bargaining table simply because it no longer needed the help of the larger company.26

Sometimes parties sometimes enter into contracts knowing that there will be future negotiations and agree to the conditions under which these negotiations will take place. A buyer, for example, might have the ability to demand changes in the part that the supplier is making. Toyota reserves the right to make changes with respect to any parts that the supplier sells, and the supplier commits to making them. The changes extend to the drawings and specifications of the parts and also to anything else within the scope of work “including such matters as inspection, testing, quality control and other matters ancillary to the production” of the parts. The changes are to be set out in contract documents that Toyota supplies and all the changes “shall be made in strict conformity with such documents.”27

If the changes result in a material increase (or decrease) in the cost or time of performance, Toyota bears the cost (or enjoys the benefit), just as it would if Toyota did the production itself. But sorting out the costs of change requires negotiation. The agreement between Toyota and its supplier provides that each must “negotiate in good faith a reasonable allocation of such costs or other equitable adjustment of the relationship between the parties.” Exactly how the parties negotiate also turns on the consequences that follow in the event that the parties cannot reach agreement even if both do act in good faith. In this particular example, Toyota reserves for itself the final word:

In the event the parties cannot mutually agree . . . concerning Required Changes and the impact of such changes, or if Toyota Party reasonably deems it necessary to implement Required Changes without consultation, such Required Changes shall be effective as directed by Toyota Party.28

27 See Toyota Terms and Conditions §4.1(a).
28 See Toyota Terms and Conditions §4.1(b).
Toyota’s ability to take advantage of the supplier, however, is limited by the right of the supplier to terminate with six-months’ notice (and imposing on Toyota the significant costs of finding and qualifying a new supplier) and the reputational hit that Toyota will suffer in its supplier network if it acts arbitrarily in readjusting prices.

Parties can devise other environments to govern future negotiations. The parties can, for example, agree to negotiate in good faith and that, if negotiation fails, submit the matter to arbitration. When they pick the type of arbitration, they take into account how the process will itself affect the negotiations that take place in its shadow. Final-offer arbitration is commonly justified on the ground that it facilitates settlement. A worker and her employer might agree that her salary will be renegotiated at a later time to take account of her performance and salaries paid for comparable performances in the industry. They might also agree to put the matter to arbitration if they failed to reach agreement. In one industry, workers and employers use final-offer arbitration to resolve salary disputes. Each side negotiates with the other in the good faith. If they cannot agree, the arbitrator must choose between the last offers each made to the other.

Those who justify final-offer arbitration argue that it gives each an incentive to make offers that reflect the underlying value that the employee brings to the firm. In ordinary arbitration, arbitrators are inclined to split the difference between the position of each side and that this drives parties to extreme positions. Final-offer arbitration, by contrast, gives each party an incentive to make a reasonable proposal, given that, if she does not and the other does, they will lose the arbitration. Because each makes reasonable offers, they are more likely to reach a consensual bargain than if they bargained in the shadow of conventional arbitration. In one industry that uses final-offer arbitration to determine salaries, only a handful of negotiations ever breakdown in a given year.29

Parties may use a third party as a backstop just to fill in terms that must be left open when parties enter into a contract. They might have an ongoing relationship and agree that a person they identify in their contract (a “wise man” as such a person is called) fills in any terms upon which they cannot agree. The ability to turn to such a person again affects the dynamics of the negotiations. There is no point in making extreme demands, as the other party has recourse to a mechanism that will put in place a reasonable term in the absence of agreement.

B. Bargaining and Disclosure Obligations

When the United States and North Vietnam bargained over the shape of the table, they were in fact negotiating over the ultimate status of the South Vietnamese government and the National Liberation Front. Both sides knew it, and this is precisely why the deciding on the shape of the table took so long. What took the form of preliminary negotiations about procedure were in fact negotiations about substance.

In theory, a party should not be able to change what the ultimate bargain looks like by insisting on particular bargaining rules. Whatever keeps her from achieving a particular term directly in a final bargain should prevent her from acquiring it indirectly by reshaping the bargaining environment. If asking for a prenuptial agreement signals bad information, then asking to change the bargaining environment to one in which negotiating the prenuptial agreement would be possible signals the same information. In equilibrium, each party should be able to take account of how the bargaining mechanism will shape the final bargain and react accordingly.30

offer arbitration in fact makes consensual agreement more likely can be debated. See Tymofiy Mylovanov & Andriy Zapechelnyuk, Optimal Arbitration, 54 International Econ. Rev. 768 (2013). What matters for present purposes is that it is likely to affect the behavior of the parties.

30 This intuition is suggested by the revelation principle. See, e.g., Roger B. Myerson, Incentive Compatibility and the Bargaining Problem, 47 Econometrica 61 (1979).
Situations do arise, however, in which parties want a bargaining environment for reasons other than enabling them to reach a particular outcome. Consider the parol evidence rule. It allows parties to alter their bargaining environment. The rule makes it possible for parties to alter their bargaining environment retrospectively. A fully integrated agreement prevents anything that said during the course of the negotiations being mistaken for a promise that is part of the bargain. When parties come to sign the contract, they are signing under conditions in which various promises that legal rules might otherwise fold into the bargain remain outside of it.

Parties negotiate differently as soon as they know that they will be signing an integrated contract. If one party makes it plain that a deal, if it arises at all, will be executed with a contract that contains an integration clause, then both parties will conduct their negotiations differently. They may put items on the table and insist on the resolution of issues that they might not otherwise. The substance of the final bargain may change in the process. Even if the question of having a fully integrated contract arises only towards the end of the negotiations, it may reopen issues and put various issues into play that might otherwise been left untouched.\(^{31}\)

The value of the parol evidence rule may turn in large measure on exactly how useful it is for parties to be able to set the ground rules for their negotiations. In a legal regime that has a strong version of the parol evidence rule, parties find it easier to know where they stand. When parties know that they will enter into a completely integrated agreement, they know which of their undertakings are legally enforceable.\(^{32}\)

\(^{31}\) As discussed in the next Part, parties regularly agree upon integration clauses before settling on the terms of the contract. Parties will often have master agreements that, even though they do not create any legal obligations, will have clauses that work as integration clauses if parties do subsequently enter into a legally enforceable bargain.

\(^{32}\) This might be part of the reason sophisticated commercial actors tend to favor New York over California when they resolve conflict of law issues through contract. See Theodore Eisenberg & Geoffrey P. Miller, *The Flight to New York*:
A legal rule also affects the norms that govern the party’s behavior. The parol evidence rule might both limit the legal obligations of the parties and also affect the way that parties otherwise treat their negotiations. The parol evidence rule has the effect of signaling, “What is written here and only what is written here is what either one of us is obliged to do.”

For an example of how such norms might work, consider the United States Constitution. At the outset of its deliberations, those who attended the convention agreed to keep its discussions confidential. They thus could not later be used during the first decades of the Republic to interpret the Constitution. The resolution, although not itself legally enforceable, created a strong norm that had the effect of privileging the text itself. The expectation that the resolution would be honored also changed the way they negotiated during the Constitutional Convention itself. Someone like Hamilton could put forward ideas without fear that doing so would compromise his own ability to advocate in favor of a final product that did not include it.

Parties can go one step further. In addition to creating a fully integrated agreement, they can also recite in their agreement that they are not relying on any representations made during the bargaining process. By adding such a provision, parties eliminate not only the ability of the other side to sue on the contract, but potentially the ability to sue for fraudulent misrepresentations as well. The recitation, if it is taken at face value, has the effect of taking away from the parties the ability to assert reliance on the misrepresentation, an essential element of any cause of action based on fraud.


33 The idea that formal rules and norms interact in this fashion is one of the themes of Gilson, Sabel & Scott, supra 7.

34 See 1 The Records of the Federal Convention of 1787 (Max Farrand ed., 1911) 15 (Journal, May 29, 1787) (resolution “[t]hat nothing spoken in the House be printed, or otherwise published, or communicated without leave”).

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Consider again the various rules governing obligations of the parties to disclose material information to each other. Sophisticated traders might want to be able to bargain in an environment in which the terms of engagement made it clear that no disclosure obligations exist. Each wants to bargain without worrying about whether she has been sufficiently forthcoming.

Even though the general rule is one that does not require either party to disclose material, nonpublic information to the other, the rules in practice are somewhat more complicated. Obligations to disclose creep in around the edges. Some jurisdictions, for example, require disclosure when one party to a transaction knows that disclosure “would correct a mistake of the other party as to a basic assumption on which that party is making the contract and if nondisclosure of the fact amounts to a failure to act in good faith and in accordance with reasonable standards of fair dealing.”  

The owner of a building brings in a second contractor to repair the mistakes of a previous one and fails to disclose a number of defects that are not readily observable that will make the job much more costly than first appears. The owner of an amusement center containing a number of different concessions with pinball machines and other devices that might or might not be legal sells it knowing that the police plan to raid the establishment and close down many parts of it. Someone with a rubbish collection business sells it knowing that there is a strong possibility that the city will let a contract for the rubbish collection and render the business superfluous.

Courts have not decided these cases uniformly, but the difficulties they raise complicate the blackletter doctrine with respect to disclosure obligations. Particularly when it comes to buying and selling financial instruments, there

35 Restatement (Second) of Contracts §161(b).
may be a background duty that requires parties to reveal material nonpublic information.\textsuperscript{40} If both parties want to escape from such a legal regime, they need to change the bargaining environment.

It is possible for the parties who want to trade on the basis of material, nonpublic information to come close to creating such a bargaining environment by exchanging letters in which each recognizes that the other might be in possession of material nonpublic information and affirms that she is not relying in any way on the failure of her contracting opposite to disclose it.\textsuperscript{41} Because reliance is an essential element of any action for fraud or nondisclosure, the effect of such letters is to create a contracting environment in which there are reduced disclosure duties.\textsuperscript{42}

The purpose of these “Big Boy” letters is not to allow someone with private information to take advantage of the other party. If all a party is doing is trying to trade on the basis of private information, the act of demanding a Big Boy letter itself reveals that she is in possession of it. But the purpose of these letters is to alter the bargaining environment itself in a fashion that is in the mutual interest of both parties. Both of them are better off with an environment in which there is greater transactional certainty even if it is at the cost of less protection for nondisclosure and an increase in sharp practice.

Parties can find the ability to eliminate fraudulent misrepresentation actions useful in many environments. While parties are negotiating, what one party

\textsuperscript{40} The U.S. Supreme Court suggested a disclosure obligation may exist in face-to-face transactions in Strong v. Repide, 213 U.S. 419 (1909).


\textsuperscript{42} It is not clear that these “Big Boy” letters shield parties from liability under Rule 10b-5. Although reliance is an essential element of the private cause of action, it does not bind the SEC, and the SEC is worried not so much about the person who acquires a security after signing a Big Boy letter, but the person to whom it is later sold. These letters, however, are useful in the context of distressed debt trading if the debt is not a security, a question that is itself contested. See Robert D. Drain & Elizabeth J. Schwartz, Are Bankruptcy Claims Subject to the Federal Securities Laws?, 10 Am. Bankr. Inst. L. Rev. 569 (2002).
believes is small talk or puffing might be understood by the other as an implied promise. One brother wants to buy out the other’s stake in the family business. During the negotiations, he makes a vague statement to the effect that he has no intention of selling the business. He wants to be sure that such statements do not bind him to keep the firm in the family indefinitely and that his brother understands this. A clause in the contract that makes it clear that no such representations, however understood, should be treated as binding keeps such misapprehensions from arising.

Hence, if, shortly after the one brother sells his stake to the other, the brother who bought the company has the chance to sell it at a profit to a third party, he is free to do so, at least as a legal matter. The other brother cannot claim that his brother intended to sell the firm all the time and that he was tricked into selling for a lower price than he would have otherwise. If the parties have an agreement in which each agrees that neither relied on any representations that the one made to the other during the course of negotiations, then the lawsuit by the disappointed brother is foreclosed. Reliance is an essential element of the fraud action.

Through this device, parties are able to define the nature of the negotiations that passed between them. They signed the contracts knowing that they were operating under terms of engagement that were different from the one that the law ordinarily has in place. By having an integrated agreement that included a clause to the effect that neither was relying on any representations by the other, courts will understand that the ordinary ground rules do not apply.

Of course, treating recitations in contracts in this fashion makes sense only if parties to the contracts take them seriously. The potential for abuse here is manifest. For example, a filmmaker intent upon making fools of ordinary people can take advantage of such a rule. He can put on a thick, Slavic accent and claim, falsely, that he is a journalist doing a documentary (which will be called,

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43 This hypothetical is based on Rissman v. Rissman, 213 F.3d 381 (7th Cir. 2000) (Easterbrook, J.).
“Cultural Learnings of America for Make Benefit Glorious Nation of Kazakhstan”) for distribution exclusively in his home country. He then can hand his unsuspecting subjects a release that gives him permission to use any film he shoots and show it anywhere. The release also includes a clause to the effect that they are not relying on any representations he made to them before they signed. They are at risk if it turns out that he is not from Kazakhstan at all, but a British comedian who specializes in revealing the racism, homophobia, and gullibility of ordinary people.

As a general matter, the victims of such a movie producer have no ability to recover even when the film ultimately grosses more than $260 million and makes them look ridiculous. Their signed statements to the effect that they did not rely on any representations from the film producer prevent them from bringing a fraud action. Again, reliance is an essential element of a fraud action, and signing a document in which they represent that they are not relying on anything they were told estops them from claiming otherwise.

There are many reasons to corral the ability of parties to alter their bargaining environment in this fashion, especially in the consumer context where they are most unlikely to read the fine print. Allowing parties to create an


46 Because of the potential for abuse, courts sometimes look at the surrounding circumstances to ensure that the statement that there was no reliance on previous oral statements can be taken at face value. See, e.g., Brown v. Earthboard Sports USA, Inc., 481 F.3d 901, 920–21 (6th Cir. 2007); AES Corp. v. Dow Chemical Co., 325 F.3d 174, 180–81 (3d Cir. 2003); Jackvony v. RIHT Financial Corp., 873 F.2d 411 (1st Cir. 1989) (Breyer, J.); One-O-One Enterprises, Inc. v. Caruso, 848 F.2d 1283 (D.C. Cir. 1988) (R.B. Ginsburg, J.). Courts are especially reluctant to enforce these clauses disclaiming reliance when they are fine print in consumer contracts that parties are unlikely to read. See, e.g., Cirillo v. Slomin’s Inc., 768 N.Y.S.2d 759 (N.Y. Sup. Ct. 2003).

adults-only bargaining regime increases the risk of actual fraud. It is useful nevertheless to understand why such rules might be mutually beneficial. The rationale for allowing parties to call these rules off is not that actual fraud is bad, but rather because proving fraud is hard and subject to error in a world in which memories are faulty and one person’s puffing is another’s solemn promise. The cost of fraud needs to be weighed against the value of transactional certainty.

C. Stickiness and Custom Defaults

Parties may also find it useful to create their own bargaining environment when they face the prospect of extended negotiations with each other. For example, a creditor and a distressed debtor often enter into a restructuring support agreement with each other in which both parties agreed to work together to put a plan of reorganization in place.\(^{48}\) They each undertake work with each other to forge such a plan and implement it according to the timetable and the parameters set out in their agreement, rather than the one that the Bankruptcy Code puts in place.

Debtors often never formally assume restructuring support agreements after they file for bankruptcy. As a result, it is not legally binding on the debtor.\(^{49}\) This and other understandings about the bargaining environment that are not legally enforceable present something of a puzzle. It might seem that it does not bring any benefit given that each party is entitled to ignore the understanding and insist on whatever bargaining environment it wants.

Of course, a background set of default rules might simply save costs if the parties plan on repeat dealing and nothing changes from one deal to the next. The transaction costs are simply lower. The movie Trading Places offers a familiar example. Two brothers, Randolph and Mortimer Duke, regularly enter into wagers with each other. They have an agreed understanding about the stakes. They remain free, of course, to set the stakes for new bets at any amount they want, but, by virtue of the understanding they have put in place, they have

\(^{48}\) For a description of how these work, see Douglas G. Baird, Bankruptcy’s Quiet Revolution, 91 Am. Bankr. L.J. 593 (2017).

fashioned a default rule for themselves about the stakes. When they enter into a bet, they can agree, without any need for elaboration, that the bet is for the “usual amount.”\textsuperscript{50} If they want some other terms, the “usual amount” provides a starting point.

Such agreements establish the backdrop against which their negotiations will take place. The presence of transaction costs ensures that there is some stickiness to the default rules and this itself might work to the ex ante benefit of the parties. The prospect of future dealings might lead one or both parties to make relationship specific investments. Having some terms in place that are hard to change may prevent future advantage-taking. Once the default terms exist, it will be cheaper to use them rather than any other. A party intent upon advantage-taking has to weight its benefits against the lower costs of entering a contract according to the default terms that the parties have already crafted.

The transaction-cost savings from having a customized set of default may not be that powerful. Many of those that we see are not highly tailored to specific transactions.\textsuperscript{51} Parties may be reluctant to give up default terms once they have been agreed upon even when they are not particularly valuable as customized defaults. A party might be sufficiently attached to the default terms even when

\textsuperscript{50} The bet that is the focal point of the movie is over the result of an elaborate and costly “scientific” experiment over whether career success is the product of nurture or nature. Randolph believes that success in business is entirely a question of education and upbringing. Hence, he bets that he can turn a random street hustler (played by Eddie Murphy) into a successful managing director of a commodities trader, and at the same time he can transform a successful managing director (Dan Ackroyd) into a petty criminal. Randolph wins his bet and collects the “usual amount,” which turns out to be a dollar.

\textsuperscript{51} In the American automobile industry, for example, the same terms and conditions are applied across a vast range of products, and they do not seem to change even when the industry goes through dramatic change. Moreover, terms and conditions did not seem to be crafted with the care one would expect if they were written with efficiency in mind. See Omri Ben-Shahar & James J. White, Boilerplate and Economic Power in Auto Manufacturing Contracts, 104 Mich. L. Rev. 953, 979 (2006).
they are not legally enforceable that the other party would be unable to negotiate better terms. This behavioral bias in favor of terms already agreed upon might prevent a better deal that was mutually beneficial, but the reluctance to change from default terms might prevent advantage-taking as well.\textsuperscript{52}

It is also possible that the default terms are sticky because a party who insisted on renegotiating default terms might signal that they were not desirable trading partners.\textsuperscript{53} Assume that a buyer and a supplier agree on a set of general default terms, but do not yet know enough to enter into a formal, legally binding contract. All else equal, when the time comes to enter into a legally enforceable contract, the supplier could insist on terms that took advantage of the costs that the buyer had already sunk into the relationship. But there are two types of suppliers when it comes to performance of the contract. Some will provide consummate performance over and above what a court will enforce. Others chisel. But whether a supplier is one type or another is known only to the supplier. Suppliers who chisel are more inclined to renegotiate default terms than those who provide consummate performance.\textsuperscript{54} In this environment, default terms may prove sticky because those who are inclined to chisel will want to conceal their type. A pooling equilibrium emerges in which the default terms upon which parties set in the place in the outset do not change.

\textbf{III. Terms of Engagement and Master Agreements}

Establishing a bargaining environment is a regular part of commercial life. Manufacturers have long-term relationships with many of their suppliers. It is

\textsuperscript{52} This is idea of “concession aversion” is a variation on the familiar idea in behavioral economics of loss aversion. See Daniel Kahneman & Amos Tversky, Conflict Resolution: A Cognitive Perspective, in Barriers to Conflict Resolution, 56-57 (1995).

\textsuperscript{53} The idea that terms constrain parties because of reputation consequences has been noted in many contexts. For an excellent discussion, see Claire A. Hill, A Comment on Language and Norms in Complex Business Contracting, 77 Chicago-Kent L. Rev. 39 (2001).

\textsuperscript{54} This idea that parties might chisel during the course of performance is one that Hart and Moore use in their discussion of reference points. See Oliver Hart & John Moore, Contracts as Reference Points, 123 Quarterly J. Econ. 1 (2008).
common that a manufacturer will enter into a master agreement with a supplier. Such master agreements are not necessarily themselves binding contracts. They often do not oblige either party to do anything. Each remains free to enter into a deal with the other on entirely different terms, just as the brothers in Trading Places could enter into a bet on something other than “the usual amount.” They are the point of departure is what is provided in the master agreement, not from the ordinary default rules of contract law.

Some of the benefits of having such terms in place are the ones that apply to customized terms of engagement discussed in the previous part. There are others that may be more specific to the buyer-supplier relationship. The master agreement can have the effect of separating matters that are the domain of lawyers (such as ownership of intellectual property) and the domain of managers (such as pricing and delivery schedules). In a large firm, such master agreements make it easier to delegate. The head of purchasing might not want her agents to negotiate with a new vendor on a blank slate, but might be willing to allow them to negotiate with a vendor for a new part if the basic parameters of new deals were laid out.

There may be other benefits as well. When a buyer has a standard master agreement it uses with its suppliers, new suppliers can enter into bargains somewhat confident that they are doing business on the same basic terms and conditions as others. Trade associations can gather the basic terms and conditions of each buyer in an industry and make them available to suppliers. They know at the outset which each potential customer generally offers to others.

But one should not exaggerate this benefit. A supplier does not see the actual purchase orders the buyer issues to other suppliers. It does not have any way to be sure that other suppliers are allowed to cut more favorable deals than the standard terms suggest. But the basic terms of engagement, such as the standards that the buyer will bring to bear in assessing performance, are likely to

be same across most suppliers. Vendors can have some sense of the terms and conditions that various buyers in an industry offer. These are, of course, only a starting place, but they do give suppliers some ability to gain their bearings.

When multiple buyers in an industry incorporate the same industry standards, it becomes easier for suppliers to enjoy the economies of scale associated with supplying multiple people in the same industry. In the American automobile industry, for example, it is common for a Tier One supplier to do business with most of the major OEMs. When a buyer establishes terms of engagement that are the same across suppliers, it is easier for other suppliers to assess whether the buyer acted impermissibly in terminating someone. If they know from their own experience with a standardized contract what Harley will not tolerate, they will not blame Harley for being arbitrary in cutting someone else off when it terminates a supplier for doing something that the master

Of course, it is one thing to have a set of standard terms and quite another to insist on them. Nevertheless, in a given industry, parties are likely to have some idea about which buyer’s terms are more or less immutable and which are not. Ben-Sahar and White report that, among domestic automobile manufacturers in the early part of this century, the terms of General Motors and Ford were more or less set (outside of contracts involving the licensing of intellectual property), while those of Toyota and Honda’s terms and conditions were more flexible. See Omri Ben-Shahar & James J. White, Boilerplate and Economic Power in Auto Manufacturing Contracts, 104 Mich. L. Rev. 953, 979 (2006).

This is at least the claim that Harley implicitly makes about its master supply agreement when it emphasizes that its master supply agreement “was developed with a handful of companies and worked into a pilot mode of operation with our Supplier Advisory Council.” For a discussion of Harley’s Supplier Advisory Council and the various roles it plays, see Lisa Bernstein, Beyond Relational Contracts: Social Capital and Network Governance In Procurement Contracts, 7 J. Leg. Analysis 561, 607-08 (2015).

Lear Corporation, for example, supplies entire seats to virtually all of the world’s major automobile manufacturers. See http://www.lear.com/Site/Products/Seating/.
agreement puts out of bounds. But they will also understand when Harley is not following the terms of engagement and is thus engaging in hold-up behavior.

Being able to establish a template for their transactions instead of putting in place a long-term contract also allow a buyer to have a relationship with a supplier that it is able to terminate without sending information to others in its network. If the buyer can simply stop placing orders, it does not have to invoke a termination clause, a step that has reputational consequences for both the buyer and the vendor. It might be in the mutual interest of the parties to have a relationship that was both long-term, but allowed each to exit easily.

When two parties are likely to have repeated dealings, it can be useful to begin each round of negotiations with a set of default terms more tailored to their interests than the off-the-rack terms of the Uniform Commercial Code. These standardized terms often take on a life of their own. Parties develop terms between themselves. At the outset, however, there is simply a standardized set of terms governing one-on-one trades. But terms originally developed between merchants can become model terms used by a larger group. Once terms of engagement become regularized among a larger group of merchants, terms of engagement become markets. The standardized terms developed by the Chicago Board of Trade ultimately made commodities markets possible. The many trillions of dollars traded in derivative markets all use the International Swaps and Derivatives Association’s master agreement.

Ben-Shahar and White caution, however, that we should not be too quick to assume that these master agreements necessarily work in this fashion. See Omri Ben-Shahar & James J. White, Boilerplate and Economic Power in Auto Manufacturing Contracts, 104 Mich. L. Rev. 953, 979 (2006). Some American automobile manufacturers, however, incorporate industry standards into their terms and conditions. This may have the effect of creating a large number of obligations that are efficient. See note 62 infra.


When goods are fungible and the delivery terms customary, there is little need for a master agreement. If a buyer needs a standard part at the market price, there is little to do other than adopt the default rules of contract law or the customary terms that have been developed in the industry. But even goods that appear relatively generic might not be. Even a contract for a fungible commodity can be complicated. A buyer who organizes production around just-in-time delivery faces complicated issues even when the parts are completely standardized. And ordinary-looking parts are not necessarily standardized. In many industries, the typical buyer will do much more than simply provide specifications for the product. There are elaborate requirements about the tooling the supplier must use, the protocols for approving the tooling, the testing procedures for prototypes and the final product, and the audits that can be performed.\textsuperscript{62}

Master agreements often give the buyer the ability to inspect the supplier’s premises and also require the supplier to obtain the permission of any toolmaker it uses to inspect its premises as well.\textsuperscript{63} It might insist on a version of the perfect tender rule that gives it the right “in its sole discretion” to reject tooling if it is not in strict conformity with its requirements.\textsuperscript{64} A buyer with such terms and conditions begins its bargaining with a new supplier with this right as the starting position. The supplier can try to insist on something else, but the terms and conditions establish the starting point of the negotiations.

\textsuperscript{62} A buyer of automobile parts, for example, insists production processes and quality control procedures that are detailed and elaborate. BMW’s master supply agreement is typical. See, e.g., BMW Group International Terms and Conditions for the Purchase of Production Materials and Automotive Components §9.2 (2014) (“Seller will use the Series Process Quality Evaluation to produce initial samples of the Goods. Seller will inspect initial samples in accordance with the VDA publication “Quality Management in the Automotive Industry, Volume 2: Quality Assurance of Supplies”). The VDA in turn requires the supplier to put in place elaborate processes that meet its own set of elaborate certification requirements. See, e.g., Verband der Automobilindustrie, Quality Management in the Automotive Industry: Quality Assurance of Supplies, vol. 2 (3d ed. 1998).

\textsuperscript{63} See Toyota Terms and Conditions §3.6(a).

\textsuperscript{64} See Toyota Terms and Conditions §3.6(b).
Having standard terms and conditions also makes it easier for a buyer to ensure its suppliers understand its expectations. For many buyers, it is not enough that the buyer can reject them under the perfect tender rule or sue for damages. If the supplier does not understand the buyer’s expectations, the buyer has no interest in doing business with it. Nor is it in the interest of the supplier to do business with the buyer.

Consider Harley-Davidson. Harley is not particularly interested in high-performance motorcycles, but it is intensely interested in a brand that resonates with a particular demographic. It has no interest in suppliers who do not understand the importance of shiny black paint and the perfect chrome finish on the bikes it sells. Harley is selling an image and a life-style. A nontrivial component of its revenues come from selling branded products other than motorcycles. If a vendor is just interested producing components that meet the most demanding operational specifications, it should not do business with Harley. It makes sense neither for Harley nor for it.65

Toyota’s terms and conditions specifically invoke its Guiding Principles. Its suppliers must commit to “use their commercially reasonable efforts to comply with the Guiding Principles.” A failure to follow the Guiding Principles would rarely give rise to any damage actions, but their presence may help to inform suppliers what they are signing up for. Moreover, a failure to follow some of them, such as “exhibiting proper care and concern for the environment and

65 Harley’s aspirations are reflected in its own characterization of is Master Supply Agreement for potential suppliers:

The MSA is not a long-term commitment; rather it is a commitment about how we will operate in the long-term. Part of a healthy and well-grounded relationship is to discuss then basis of collaborative efforts. The MSA forces both Harley-Davidson and the supplier to get the issues on the table before they cause problems. With an MSA in place, both companies can rise above hard-to-read terms and conditions on the back of a purchase order and stay focused on more relevant issues of doing business.
“safety” might provide grounds for termination for breach, even if they did not provide an avenue for the recovery of expectation damages.\textsuperscript{66}

Buyers often require commitment to basic values as well. BMW, for example, forbids its suppliers from discriminating on many grounds, over and above what local law requires, including sexual orientation. In addition, BMW makes it the supplier’s responsibility to ensure that none of its subcontractors discriminate either.\textsuperscript{67}

But the terms and conditions alone may do little more than focus discussion. What matters when such language appears (as it regularly does) is how seriously it is taken. For years, British Petroleum promoted itself as a firm that cared about the environment, but inside the industry it was common knowledge that it did not. An important part of the process of negotiating a master agreement is for the buyer to make it plain just how seriously its terms are taken. Having a shared understanding of the role the buyer can play in the supplier’s own operations may be as important as whether the terms of engagement are themselves legally enforceable.

The way master agreements and the like allow parties affect the way that bargaining plays out subsequently may be what matters most. Indeed, master agreements often attempt to displace the law that governs the formation of contracts. Toyota, for example, makes an explicit attempt to opt out of 2-207, the Uniform Commercial Code’s rule for the “battle of the forms.”\textsuperscript{68} Its terms and conditions are set out in a master agreement. In the event of any inconsistency, the Terms and Conditions are to control.\textsuperscript{69}

BMW also makes its own effort to displace other law through its terms and conditions. It also attempts to put in place its own Statute of Frauds. The

\textsuperscript{66} See Toyota Motor Engineering & Manufacturing North America, Inc. Terms and Conditions §1.9(b) (2009).

\textsuperscript{67} See BMW Terms and Conditions §20.

\textsuperscript{68} Section 7.5 of its terms and conditions recites, “The parties have agreed and it is their intent that the battle of the forms section of U.C.C. 2-207 of the Uniform Commercial Code shall not apply.”

\textsuperscript{69} See Toyota Terms and Conditions §7.5.
Uniform Commercial Code allows some contracts to become effective even if only one party signs it.\textsuperscript{70} BMW does not. It provides that any amendment or modification of any provision of its terms and conditions must be in writing and signed by both parties.\textsuperscript{71} It also explicitly attempts to exclude the United Nations Convention on Contracts for the International Sale of Goods from applying to its supply contracts.\textsuperscript{72} The CISG allows some contracts to come into being through communications without a formal contract being signed. BMW attempts to prevent this from happening.

Whether it is possible for contracting parties to call off the battle of the forms or the Statute of Frauds might be doubted, but the overall effect is to limit the ability of agents on the ground to change the nature of the relationship, as opposed to the particulars of a given purchase order. Ford’s master agreement takes matters one step further. Ford’s Vice-President for Global Purchasing must specifically approve modifications proposed by the supplier to its terms and conditions.\textsuperscript{73}

The terms of engagement control the behavior of agents, both those of the supplier and the buyer. Nonlawyers negotiate service-level agreements, establishing things such as time of delivery. Principals worry that these agreements can alter obligations in ways that the agents do not even understand. Principals of the supplier, for example, want to ensure that a warranty for which it is not compensated does not enter the contract on account of the casual representations of their own people. In the absence of the master agreement, a warranty under U.C.C. 2-313 comes into being whenever a description becomes part of the basis of the bargain. An agent might do this in a friendly conversation over drinks. Similarly, the principals for the buyer do not want their own people on the ground to compromise their standards or ability to inspect. By providing in the master agreement that it trumps when terms are inconsistent, the terms of

\textsuperscript{70} U.C.C. 2-201(2).
\textsuperscript{71} BMW Terms and Conditions §21.1.
\textsuperscript{72} BMW Group International Terms and Conditions for the Purchase of Production Materials and Automotive Components §22.1.
engagement tie the hands of all the lower-level people. By establishing terms of engagement, contracting parties can reduce their own agency costs.

At the same time, by demarcating the regime in which the principals of the firm establish some terms of engagement, master agreements also set out a realm in which the agents can negotiate with each other apart from their principals. The agents can reach a bargain over price without worrying that one or the other will attempt to circumvent the bargain they strike by negotiating with their opposite’s principals. Because delegation is valuable, it is useful for principals to tie their own hands at the outset.

Many of these rationales for having terms of engagement do not require legal enforceability of the master agreement itself. Legal enforceability may matter only because of the constraints it places on agreements that are ultimately reached. The terms of engagement do much of their work without legal enforceability. They fix expectations and establish focal points, and they give shape to the legally enforceable deals that do emerge.

IV. Master Agreements and the Nature of the Firm

Master agreements create a nether world between one-shot transactions and long-term contracts. Their effect is often to blur the difference between production inside and outside the firm. They typically give the buyer ownership of the customized tooling that the supplier acquires just as the buyer would own the tooling if the buyer made the parts itself. The supplier has possession of the tooling while it is making components, but the buyer has the right to take the tooling back when the contract comes to an end. With such master service agreements, decisions about whether to locate production inside a particular legal entity or acquire it from another are unlikely to turn on asset ownership.

74 For an elaboration of this idea, see Zohar Goshen & Richard Squire, Principal Costs: A New Theory for Corporate Law and Governance, 117 Colum. L. Rev. 767 (2017).

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The master agreement is also structured in such a way that one of the standard arguments for bringing production inside the firm—the risk of hold-up behavior on the part of third parties—is minimized. Of course, the buyer does, in theory, have some opportunity to take advantage of a supplier. Even though the supplier has not committed capital to tooling that is dedicated to a particular buyer, it has invested in the relationship. But there are reputational sanctions if the termination is done in a way that violates the norms that the buyer itself creates among the supplier network. Buyers also limit their own ability to engage in hold-up behavior. They can, for example, make a practice of refusing to enter into contracts that would make them the source of more than twenty to thirty percent of a given supplier’s revenues. Buyers have no interest in being able to pull the plug on their relationships if they do not have to. It will work with suppliers to help correct defects, just as employers try to work with employees who are not doing what is expected of them.

For its part, the supplier’s ability to hold up the buyer is limited to the costs the buyer faces when it has to relocate the equipment and qualify another supplier. To be sure, if the buyer has little in the way of inventory of the necessary parts, the termination may lead to the shutdown of the entire production line. Hence, these switching costs are not trivial, but they do put a cap on the ability of the supplier to engage in hold-up behavior. Suppliers are in any event checked by the reputational hit they take if they engage in hold-up behavior. They have to worry not simply about the loss of future business from

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75 Others have shown how other types of agreements, such as the standard agreements used in complicated construction contracts, can work in the same fashion to narrow the difference between production inside a single firm and contracting with third parties. See Surajeet Chakravarty & W. Bentley MacLeod, Contracting in the shadow of the law, 40 RAND J. Econ. 533 (2009).

76 See Bernstein, supra note 57, at 607-608.

77 Bernstein has to be credited with this insight, along with many others, about the way that buyers and suppliers structure their relationships. See Bernstein, supra note 37, at 585.

78 For Harley-Davidson’s account of its own corrective action procedures, see https://www.h-dsn.com/genbus/PublicDocServlet?docID=38&docExt=pdf.
the one buyer it is holding up, but the reaction of other buyers. These other buyers have often only a master agreement in place and are not obliged to place any orders. It can find other sources secretly and cease placing orders when a supplier misbehaves.

What matters more are the powers the master agreement grants that persist for the life of the relationship. In many industries, master agreements give the buyer the ability to inspect, test, and otherwise control how the product is produced. The buyer’s agents can enter the supplier’s factory, approve its procedures, oversee its tests, and audit it afterwards. The supplier must accept and process orders using the buyer’s proprietary software.79

The environment that a master agreement establishes between the parties, even when the parties do not establish a legally binding obligation between themselves, has the effect of making the relationship between a buyer and its suppliers very much like relationship between agents inside the same legal entity. A car manufacturer might build its own instrument panels or acquire them from elsewhere. In either event, the relationship between the person in charge of designing the car and the person in charge of making the instrument panel may be largely the same. The protocols for reviewing the design, testing the tooling, and establishing production processes may be the same. Master agreements put in place a set of procedures that resemble those that large firms use to manage their internal operations.

Firms create the equivalent of terms of engagement inside a firm. There are protocols and terms for nearly everything. A large firm has an employee manual. Different employees are paid different amounts and enjoy different terms of employment, but standard policies are put in place that apply to all. Workers holding even quite different jobs in different parts of the organization can find themselves subject to the same conditions.

79 Toyota Terms and Conditions §6.1. Inspection and quality control procedures are sometimes standardized across an industry, something at that is particularly important if one supplier is providing the same product to multiple different buyers. In the automobile industry, for example, ISO/TS 16949 provides the technical specifications for the quality management system.
Firms have standardized ways of doing business. Managers in the center intrude into the operations of divisions through processes and protocols that may not be that different from the processes and protocols that are in place between the firm and its outside contractors. In short, the tests, the inspections, the design process may look very much the same whether production is done inside the firm or not. They are sticky in the same way that terms of engagement that are not legally enforceable are sticky between firms.

Changing production inside a legal entity may require reorganizing the firm and displacing employees, something that is inherently costly. A person in one division may not be able to negotiate the change successfully with someone in another division. If the negotiation proves unsuccessful, the contemplated change may not happen or the person may need to turn to another source of supply. Of course, it is possible that a single individual exercises command and control. That person can make a single decision about whether change is necessary and how production should change to accommodate it. In practice, however, changes are brought about through negotiations within a business, with the CEO acting as mediator and arbiter. The frictions associated with changing production inside the firm given the various practices that are in place are not necessarily easy than or even much different from the challenges associated with putting in place a new arrangement in light of the terms of engagement that exist between a business and another legal entity.

V. Navigating Change

Long-term contracts by their nature establish the bargaining environment that will exist if circumstances change and it becomes mutually beneficial for the parties to renegotiate the contract. Much ink has been spilt on the challenge that parties face at the outset when they foresee that, after each sinks resources into performance, one or the other may be able to take advantage of the other and seek to renegotiate the contract. Parties draft contracts with this misbehavior in mind. But parties that anticipate a long-term commercial relationship also confront a much more quotidian problem, the one that arises when circumstances change. Neither is trying to take advantage of the other nor gain a larger portion of the benefits of trade. The old deal no longer makes sense, and the parties need to renegotiate it. The bargaining environment that the parties
create at the outset will have much to do with how easily these renegotiations can take place.

Even when the need for renegotiating the original agreement is not in anyone’s mind when commercial actors set out terms that will govern their relationship, they will necessarily be shaping the bargaining environment in which these negotiations take place. The terms of the contract establish both the legal obligations of the parties. Moreover, they may also demarcate behavior that is out of bounds and that will subject to reputational and other extra-legal sanctions. One moment in the familiar story of the evolution of the relationship between Fisher Body and General Motors illustrates.

Throughout much of the twentieth century, a car consisted of three principal components—the automobile frame, the drive train, and the car body. The car body itself took decisive shape by the end of the First World War. Instead of an open body consisting of a few pieces of sheet metal or wood, enclosed, all-metal bodies became commonplace. Various pieces of sheet metal were stamped, welded together, and then mounted on top of the automobile frame.

To accommodate this move towards enclosed bodies, General Motors entered into a long-term arrangement with Fisher Body. The long-term deal between General Motors and Fisher Body brought Fisher substantial benefits. General Motors provided Fisher with a large cash infusion, and it gave Fisher a chance to supply General Motors with all its car bodies (apart from those it made from its existing facilities). General Motors promised to supply Fisher with the necessary tools and dies. It also promised to pay Fisher according to a formula that gave Fisher 117.6% of its costs, including overhead, depreciation, and interest expense. Only if Fisher reported itself unable to fulfill General Motors’ orders would General Motors be free to order car bodies from elsewhere.

As part of the deal, General Motors acquired 60% of the equity of Fisher Body, but the stock remained in a voting trust and the seven Fisher brothers retained operational control. Fisher’s own obligations under the deal were less clear-cut. Fisher had to “use the most modern, efficient and economical methods, machinery and devices consistent with good workmanship in the production of
said automobile bodies," but it is not clear how a breach here by Fisher would give rise to a damage action. More to the point, unless one read into the contract an obligation on the part of Fisher to use its best efforts to fulfill the orders the General Motors gave it, the long-term deal did not oblige Fisher to accept any orders for car bodies. It is possible that the deal itself was not legally enforceable.

But the legal enforceability of the contract was itself not of great moment. Fisher wanted to sell car bodies to General Motors, and General Motors not only wanted to buy Fisher car bodies, but it also wanted to acquire the expertise of its managers, particularly that of Fred Fisher. This pattern of forging an alliance with a firm and absorbing the human capital associated with it was common during this period. Ford’s collaboration with and ultimate acquisition of Keim Mills in the previous decade is one example. The team at Keim Mills was instrumental in developing key parts of the Model T long before it became a subsidiary of Ford, and they subsequently were responsible for many later innovations at Ford, including both the moving assembly line and wages of five dollars a day. Similarly, General Motors brought in human capital as it worked with and then acquired many companies, such as Delco (and its owner-manager, Charles Kettering) and Hyatt Roller Bearing (and its owner-manager, Alfred P. Sloan).

But the long-term deal between General Motors and Fisher Body did not anticipate the challenge General Motors was to face in the early 1920s. GM’s two leaders—Alfred Sloan and Pierre DuPont—had yet to find a way to compete with Ford. General Motors’ low-end car was the Chevrolet, and Ford’s Model T was outselling it thirteen to one. Ford held half of the domestic automobile market. To meet the challenge of competing with Ford, Sloan and DuPont turned

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80 GM-Fisher Contract, Art. III.
81 To the extent that its promise to General Motors was illusory, then the contract was not enforceable for want of mutuality. See Victor P. Goldberg, Lawyers asleep at the wheel? The GM–Fisher Body contract, 17 Industrial & Corp. Change 1071 (2008).
to William Knudsen. They asked him to find a path that allowed Chevrolet to compete on equal terms with Ford.\textsuperscript{82}

Newly arrived at General Motors, Knudsen was “the best production man in the United States.”\textsuperscript{83} And, once in charge of producing the Chevrolet, he worked miracles. Over the course of six years, Chevrolet went from selling fewer than a hundred thousand cars to more than a million. Knudsen’s success consigned the Model T to oblivion and forced Henry Ford to shut down his production for almost a year and design an entirely new car, the Model A. That car met with some success, but Henry Ford’s dominance in the low end of the car market was over. Throughout the 1930s, the Chevrolet dominated Ford.

There was no single magic formula to reducing the costs and increasing the quality of the Chevrolet, and there were missteps along the way. Among other things, it took Knudsen a long time to persuade his superiors at General Motors abandon Kettering’s ill-fated design for an air-cooled engine. Knudsen immersed himself in every aspect of the manufacture of the Chevrolet and made large and small changes at every point. For present purposes, what matters was that Knudsen decided early on a fundamental change in the way the Chevrolet was manufactured.

Automobile parts can be transported cheaply and are subject to little damage en route. Not so with finished cars. Moreover, there is no benefit to assembling cars in a single location. Once a model is produced in sufficient volume and the method for assembling the car has been refined and documented, no efficiencies are lost from having multiple assembly plants. Assembly plants consist of large


open factory floors with conveyers and pulleys that bring the pieces to the correct place. The plants are not expensive to build or replicate. It made sense to scatter them across the country so that the finished cars could be transported to dealers in each region at lower cost with less of a chance of damage.

Knudsen believed that the same principle that he brought to finished cars applied to car bodies as well. The various pieces of sheet metal that formed the car body could be shipped cheaply with little risk of damage. By contrast, a completely assembled car body is expensive to ship and dents easily. Moreover, storing an inventory of assembled car bodies was a nontrivial problem. Stamped pieces of sheet metal can be stacked; welded car bodies cannot be. Every eyewitness to these assembly plants marveled not at the physical plant itself, but rather the level of organization needed to ensure the steady flow of more than a million pounds of material each day that kept the assembly line in operation.

Knudsen saw no problem with Fisher Body continuing to stamp the various pieces of sheet metal for its automobile bodies at its own factories. These stamped parts, like other auto components, could be shipped at low cost. Nor did Knudsen believe that General Motors had any special competence in welding the different pieces of sheet metal together relative to Fisher. He wanted Fisher to continue to oversee the assembly of automobile bodies. The problem was not that Fisher assembled the bodies, but that it did so at the wrong place. Knudsen believed that Fisher’s car bodies had to be welded together at a plant adjacent to each Chevrolet auto assembly plant. He therefore wanted seven Fisher Body plants to be built next to his Chevrolet plants and physically connect to it with a system of dollies and conveyers.

84 Henry Ford had adopted this same practice the decade before, because his principal production person insisted on it. This person was also William Knudsen. The decision about how best to manufacture automobiles on a mass scale during this period was made only twice, and the same person made the decision both times. Knudsen, like most people who worked for Ford, ended up leaving him when the benefit of working for the world’s greatest designer of cars became smaller than the cost of working for one of the world’s worst human beings.
Knudsen could not force Fisher to build new assembly plants. The 1919 deal contemplated that Fisher Body would continue to assemble Chevrolet car bodies and ship them to General Motors. To be sure, Fisher was obliged to use “the most modern, efficient and economical methods,” but it is hard to read this language as requiring Fisher to relocate. The relevant provision read:

If the FISHER COMPANY by rejection of the schedules of orders furnished to it by GENERAL MOTORS, or by its failure to make deliveries as specified, should be unable to furnish automobile bodies to such extent as to interfere materially with the general program of automobile production mapped out by GENERAL MOTORS, then GENERAL MOTORS, in addition to the remedies provided above, may, at its option purchase, or cause to be constructed plant facilities for the production of automobile bodies, and thereafter be able to furnish the additional automobile bodies made by the plant or plants thus acquired.

This section of the contract does give General Motors a limited ability to build its own car bodies. But it seems unlikely that Knudsen could argue that a refusal on the part of Fisher to relocate would “interfere materially” with its general program of automobile production. In all events, General Motors did not want to build its own car bodies. It entered into the long-term deal with Fisher Body because it valued its expertise. General Motors depended on Fisher for other car bodies. Moreover, Knudsen needed Fisher’s design expertise as he developed a new model Chevrolet to compete with Ford.85

With respect to the threshold question of whether Fisher would move its assembly plants, the terms of engagement that the deal put in place were irrelevant. Knudsen could change where Fisher assembled its bodies only if he could persuade Fred Fisher that it was a good idea. In the absence of a contractual right to force Fisher to relocate, the long-term deal and the terms of engagement it put in place likely made little difference with respect to the question of whether Fisher was willing to relocate.

85 See Beasley, supra note 82, at 133.
But persuading Fisher to relocate did not prove hard. William Knudsen and Fred Fisher were kindred spirits.\(^\text{86}\) They were both production people who saw the world the same way. Relocating the assembly plants made engineering sense. Quite apart from saving costs, the car bodies would be higher quality. Among other things, there were diseconomies of scale if assembly plants grew too large. Assembling car bodies in seven different plants across the country gave managers at each plant to exercise better oversight and ensure higher quality. The move was mutually beneficial. Cars could be made with higher quality and at lower cost. For production people like Knudsen and Fisher, such a move was irresistible. They both cared about making better cars.

It was harder to persuade the managers of General Motors to approve this change in operations. Knudsen at this time was not even the president of the Chevrolet Division, but simply its operating vice president. He could not act unilaterally. He had to persuade those who ran General Motors that it was a good idea. He wanted seven assembly plants across the country, and relocating Fisher’s car assembly operation required building that many new plants for assembling car bodies as well. But one should not exaggerate these difficulties. Assembly plants are large structures, but no special machinery is involved. The capital outlay is small in the grand scheme of things, running the millions of dollars at a time when Chevrolet was spending hundreds of millions each year on raw materials.

But one should not exaggerate these difficulties. Fred Fisher at this point was already on the executive committee of the board of directors of General Motors. Far from being an adversary who was holding Knudsen up in his effort to relocate the plan, Fisher was an ally. Indeed, he soon proved Knudsen’s staunchest supporter within the corporation.\(^\text{87}\)

\(^{86}\) Ronald Coase pointed to the friendship between Fred Fisher and William Knudsen as one of the many reasons to doubt the traditional hold-up story between Fisher and General Motors. See Ronald Coase, The Conduct of Economics: The Example of Fisher Body and General Motors, 15 J. Econ. & Management Strategy 255, 266 (2006).

\(^{87}\) See Beasley, supra note 82, at 141.
There does seem to have been a stumbling block, however. Although everyone might agree that relocating the assembly operation, that did not settle the question of who was going to pay for it. Many years later, Alfred Sloan highlighted this particular issue. He said that the Fisher brothers “questioned the desirability of their putting up large amounts of capital to establish these assembly plants in conjunction with the GM assembly plants” and that “Fisher Body Corporation was unwilling to put in an investment in these assembly plants.”

General Motors had no right to force Fisher to relocate its assembly operations and, as a practical matter, it had no one else who could do the job. If they were dealing with each other as complete strangers at arm’s length, the bargaining would be over allocating the considerable benefits of building a cheaper and better car between General Motors and Fisher. These were the gains from trade. In the abstract, for Fisher to seek half of the surplus would not be hold-out behavior, but just ordinary behavior of someone transacting at arm’s length in the marketplace.

But Fisher and General Motors were not strangers. Each had and wanted to preserve a long-term relationship with the other. Moreover, the deal they had entered into 1919, which might not even have been legally enforceable in the first place, provided the starting place. Fisher Body’s arrangement with General Motors kept it from renegotiating the deal to capture the benefits that Chevrolet would enjoy as a result by producing a cheaper and higher quality car, it would have behaved illegitimately and damaged the relationship between them. Instead Fisher could insist only on being paid its costs without violating any norms or endangering its long-term relationship with General Motors. The 1919 deal put in place a bargaining environment in which the parties could bargain hard over how the costs of the new plants were to be allocated, but not over the economics of the deal more generally.

The 1919 deal did not squarely confront the sort of cost involved in building new plants. It was a cost-plus contract. Fisher was entitled to its out-of-pocket costs, plus an amount for overhead and interest expense associated with the production of car bodies. For this reason, building a plant would be included in the cost-plus formula if Fisher borrowed to build the plant, but not otherwise. The formula did not take into account capital investments Fisher made using equity rather than debt. On the other hand, the deal did not contemplate building new plants.

In the end, General Motors built three plants and leased them to Fisher, while Fisher built the other three. Given the way that 1919 deal leaves this issue unsettled parties, splitting the difference in this fashion is much what one would predict. Some time after this deal, Fisher Body adopted a pricing scheme that was more like the internal pricing used in other divisions of General Motors. And, of course, Fisher quickly became a wholly owned subsidiary of General Motors.

In short, the 1919 deal provided the background against which General Motors and Fisher sorted out the question of how to allocate the benefits and costs of an unexpected change. And it provided the bargaining environment quite independent of whether the deal itself was legally enforceable. As in many other instances, what matters is not so much the terms of engagement themselves, but rather whether they delineate the shape of the bargaining table sufficiently clearly that negotiations are possible.

89 See Klein, supra note 88, at 12.
90 It should be emphasized again that the stakes here were quite low. The assembly plants were simply not that expensive. General Motors at this point already owned 60% of Fisher and even when Fisher built the plants itself it would recapture some of the costs to the extent it financed the new plants with debt. Moreover, Fred Fisher was himself a substantial shareholder of General Motors who stood to gain considerably more personally from the success that the Chevrolet than the plants themselves could cost Fisher Body. That last thing he would want to do is stand in Knudsen way as he made General Motors competitive with Ford.
The case of General Motors and Fisher in the end was not a problem of hold-up behavior in which, because it existed outside the firm, Fisher was able to expropriate surplus. Indeed, the parties might have been confronting exactly the opposite problem. Because of his concern about his reputation, Fred Fisher might have been unable to renegotiate the terms of the 1919 deal with respect to anything other than the allocation of costs of the new plants, even if it were efficient to change other terms as well.

Imagine that between the signing of the 1919 deal and the renegotiation required the need to move the Chrysler plants other fundamentals of the relationship might have—but need not have—changed such that it was efficient to draft new terms. Bargaining for these new terms might have made both General Motors and Fisher better off, but Fred Fisher might have been unwilling to do it if these new terms were private information.

Assume again that there are two types of suppliers. The bad type wants to renegotiate irrespective of whether the fundamentals have changed as a new deal will allow more room to chisel on its own performance. The good type only wants to renegotiate when it is efficient to do so. In this setting, the good type will not recommend new terms (even when it is efficient) because it leads to a reputational hit. Fisher may limit the negotiations to the allocation of the cost of the factory even if both Fisher Body and General Motors would be better off if he did not. Older models of reputation assumed a good type that always did the right thing and a bad type who tried to mimic the good type. The newer models make both the good and bad types strategic actors. For a model that sets out this structure, see Stephen Morris, Political Correctness, 109 J. Pol. Econ. 231 (2001). I am grateful to Scott Baker for this point.

Instead of capturing too much of the gains from trade, he may have left himself with too little.

91 Older models of reputation assumed a good type that always did the right thing and a bad type who tried to mimic the good type. The newer models make both the good and bad types strategic actors. For a model that sets out this structure, see Stephen Morris, Political Correctness, 109 J. Pol. Econ. 231 (2001). I am grateful to Scott Baker for this point.

92 Relative, of course, to world of perfect information. There is no suggestion that Fisher was doing anything other than acting rationally.
V. Conclusion

That master agreements serve to provide a framework for negotiations suggests that the role that legal rules should play in this environment may be a modest one. The law may not need to go much further than making it easy for parties to delineate their obligations clearly. Imposing duties of the sort Cardozo invented in cases such as *Wood v. Lucy, Lady Duff-Gordon* may be a bad idea. First, importing nebulous duties makes it harder for parties to know exactly where they stand.93 It may make it harder for parties to appreciate the stakes and for others to impose reputational sanctions in the face of misbehavior. Second, and as important, the impulse towards finding legal enforceability should be resisted. Terms of engagement are mutually beneficial and commonplace even when they are not legally enforceable. Courts should not assume parties want such things to be legally enforceable. Often they do not.

The terms of engagement General Motors has employed in recent decades presents an interesting puzzle that Charles Sabel has identified.94 The terms and conditions that General Motors presents to its suppliers have proved remarkably durable even as underlying conditions have changed dramatically. General Motors has used much the same master agreements for decades even as the industry itself has undergone a continuous and radical transformation.95 In 1970, 93 But even here we do need to be cautious. We do see sophisticated parties incorporate such things as a duty to bargain in good faith into their contracts. See, e.g., Siga Technologies, Inc. v. PharmAthene, Inc., 132 A.3d 1108 (Del. 2015).
94 See Comments on Contract Governance, Annual Meeting of the American Economic Association (January 7, 2018). Sabel goes far beyond making this simple point about the way terms and conditions establish the playing field. In particular, he explores in particular the way in which General Motors needs to increase information flows about its own performance back to its suppliers. He shows how General Motors was able to do this in recent years and that this change did not require a change in its terms and conditions.
95 For an account of General Motor’s terms and conditions in the early 1970s, see Stewart Macaulay, The Standardized Contracts of United States Automobile Manufacturers,” in 3-21 International Encyclopedia of Comparative Law 18-34 (1974). For an account of their shape in the early 2000s, see Ben-Sahar & White, supra note 56.
cars were simple affairs. They might have looked different from the Model T, but they were in fact not that much different. A high-school student with good mechanical skills could completely disassemble and reassemble a car. Cars after 1970 are a different matter altogether. A number of innovations in construction, electronics, and composite materials have made cars orders of magnitude more complicated. Their construction and design increasingly required much more expertise and different types of expertise than before. In recent years, with the advent of electric and self-driving vehicles, they have become even more sophisticated.

This change in car design led to a change in the structure of the industry. There has been massive vertical de-integration. Henry Ford owned his own iron mines and rubber plantations. General Motors made everything from radiators to seat covers to ball bearings. Suppliers accounted only for a small part of the finished car and often served merely a duplicate source of parts that were also made internally. Today, car manufacturers rely on outsiders for the vast majority of the components of the final vehicle. Indeed, their assembly plants are far smaller. To a surprising extent, they now simply put together large complicated pieces (such as seat assemblies, instrument panels, transmissions, and engines) that are built and often designed by someone else.

Today making a great car requires forging an alliance with a great supplier. Car manufacturers now have to compete to become the favored customers of their suppliers. They want to be the one who has first access to innovation. The bargains that are struck are necessarily different, but it turns out that striking different bargains can take place in the same arena as before. The power structure has changed and the bargaining dynamic has changed, but the bargaining still takes place in the same environment.

Master agreements, a manufacturer’s standard terms and conditions, restructuring support agreements, and other documents that establish terms of engagement are odd creatures in the legal universe. There is a natural tendency to focus first on whether they create legally enforceable contracts, but this may be a mistake. To the extent they serve to create discrete bargaining environments, then what may matter more is how the legal rules are themselves making the bargaining environment itself better or worse.