CONTRACTUAL DEPTH

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Who is the intended audience of a contract? Contract theorists have identified two audiences: courts, who can levy formal sanctions for breach, and communities, who can use reputational sanctions to punish breach. Both audiences are focused on enforcement. This Article shows that there are audiences beyond courts and communities: rather, modern contracts must speak to multiple audiences, including regulators who are not party to the contract. When contracts speak to many parties, they accrue layers of meaning, which gives them "contractual depth." Contractual depth complicates both contract design and enforcement.

In advancing the theory of contractual depth, this article provides the first comprehensive account of how third parties—especially regulators—impact contract design. To do so, it uses original interviews with general counsels and law firm partners to show how designing contracts for regulatory audiences affects the substance and structure of contracts. Further, this account sheds light on one of the most important debates in contract law: the extent to which parol evidence should be considered in contract interpretation. For decades, contract theorists have been split into two camps: textualists argue that courts should not use deal extrinsic evidence to interpret contracts, while contextualists argue that extrinsic evidence is critical to understanding parties' intent. We argue that, for contracts that exhibit contractual depth, contextualism is a necessary first step in interpretation: it allows courts to separate the layers of the contract that are addressed directly to an enforcement court from those that are addressed to other audiences. This allows the court to more accurately assess the parties' intent.

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INTRODUCTION

One of 2019's biggest breach-of-contract cases was not adjudicated in a court. Rather, Facebook's breach of its terms of service—the contract it has with all of its users—was addressed by the Federal Trade Commission (FTC), which fined the social media giant $5 billion for mishandling user information.[1] This was not the first time the FTC had intervened in Facebook's contractual relationships with its users. In 2012, as part of a settlement in an FTC investigation, Facebook promised to include additional language in its terms of service about how it would use consumers' personal information.[2] From then on, Facebook's terms of service reflected not just a bilateral agreement with its users, but also its compliance with the FTC settlement.

In many types of transactions, regulators greatly influence how private parties design their contracts. Often, parties design their contracts with regulators in mind, and how a court would interpret the contract is a secondary consideration. As one general counsel interviewed for this Article put it, "internet company privacy policies and terms of use are drafted for regulators."[3]

But existing contract law and theory overlook how regulators and other institutions shape the design of contracts. This Article shows that a modern contract contains more than a straightforward message directed at a single institution—a court, which interprets and enforces the parties' promises.

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[1] Press Release, Federal Trade Commission, FTC Imposes $5 Billion Penalty and Sweeping New Privacy Restrictions on Facebook (Jul. 24, 2019), *available at* https://www.ftc.gov/news-events/press-releases/2019/07/ftc-imposes-5-billion-penalty-sweeping-new-privacy-restrictions (announcing that "Facebook, Inc. will pay a record-breaking $5 billion penalty, and submit to new restrictions and a modified corporate structure that will hold the company accountable for the decisions it makes about users' privacy." The fine and other restrictions were the result of Facebook's violation of a 2012 FTC order in which Facebook promised to make changes about how it used and obtained users' personal information); Cecilia King, *F.T.C. Approves Facebook Fine of About $5 Billion*, N.Y. TIMES, Jul. 12, 2019, https://www.nytimes.com/2019/07/12/technology/facebook-ftc-fine.html (reporting on the FTC's approval of the $5 billion fine against Facebook for mishandling user information by allowing Cambridge Analytica, a British political consulting firm, to harvest Facebook users' personal information).

[2] Press Release, Federal Trade Commission, FTC Approves Final Settlement with Facebook (Aug. 10, 2012), *available at* https://www.ftc.gov/news-events/press-releases/2012/08/ftc-approves-final-settlement-facebook (announcing that the FTC had accepted a settlement with Facebook to resolve charges that "Facebook had deceived consumers by telling them that they could keep their information on Facebook private, and then repeatedly allowing it to be shared and made public." The settlement required Facebook to take steps to fulfill its promises to consumers going forward, including giving consumers additional information and obtaining consumers' express consent before sharing information).

[3] Interview with General Counsel of an Internet Company (May 31, 2019).

Rather, modern contracts are written for multiple audiences, only one of which is a court. When contracts are written for multiple audiences, they accrue many layers of meaning, and exhibit what this Article calls "contractual depth." An understanding of contractual depth has the potential to shift how we understand contract law, theory, and practice.[4]

Contract law and theory have long focused on the role of courts. Once contracting parties satisfy the requirements of offer, acceptance, and consideration, they have the opportunity to bring disputes about breaches to a court, which then interpret the parties' meaning and enforce the contract accordingly.[5] It is therefore widely assumed, particularly in commercial exchanges, that parties make their promises with courts in mind—in other words, contracts are designed to be enforced by a court.[6]

As the Facebook example illustrates, however, many modern contracts are not so simple. Instead, parties draft contracts with not only courts in mind, but anticipate that other audiences, such as regulators and other third parties, will be readers, users, and adjudicators of the contract.

Regulatory effects on contracting, such as the FTC's intervention into Facebook's terms, are ubiquitous but largely overlooked by scholars and judges. Existing contract theory provides barely a whisper of how modern contracts are designed for multiple audiences.[7] This is a startling oversight, because

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[4] This Article is part of a larger project to reconfigure contemporary contract law to reflect the complexity of the modern economy. *See*, *e.g.*, Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NW. U. L. REV. 279 (2018) (arguing that modern agreements are complex pieces of technology, and contract law should be tailored to the structure of a contract); Matthew Jennejohn, *The Private Order of Innovation Networks*, 68 STAN. L. REV. 281 (2016) (showing how relational contracts in high technology industries are "multivalent" agreements that respond to multiple types of exchange problems).

[5] Restatement (Second) of Contracts § 17 (noting that "the formation of a contract requires a bargain in which there is a manifestation of mutual asset to the exchange and a consideration") and § 22 (noting that "the manifestation of mutual asset to an exchange ordinarily takes the form of an offer or proposal by one party followed by an acceptance by the other party or parties").

[6] This law-centered view is reflected in the very definition of "contract." *See* Restatement (Second) of Contracts § 1 ("A contract is a promise or a set of promises for the breach of which the law gives a remedy, or the performance of which the law in some way recognizes as a duty.").

[7] The closest prior scholarship has come are two articles, one by Victor Fleischer and the other by Steven Schwarcz, which argue that an important role of transactional lawyers is navigating the regulatory framework of a deal. Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227, 238 (2010); Steven L. Schwarcz, *Explaining the Value of Transactional Lawyering*, 12 STAN. J. OF L, BUS. & FIN. 486 (2007). Fleischer describes the role of a transactional lawyer as that of a "regulatory arbitrageur" who helps clients navigate regulations to obtain the best deal. Victor Fleischer, *Regulatory Arbitrage*, at 238. Although those papers touch upon the regulatory aspects of transactional lawyering, they do not address implications for contract

contractual depth exists in nearly every type of modern contract, large and small: not only internet privacy policies, but also agreements governing complex mergers and acquisitions, student loans, semiconductor manufacturing agreements, and sovereign debt. And this trend has been developing for some time, as a result of the expansion of the regulatory state.[8]

This article introduces a new theory of "contractual depth"—a comprehensive account of how non-party influencers shape both the substance and structure of modern contracts. The most important influencers are regulators, such as the FTC. However, there are many others, such as potential contract assignees and even middle managers who perform the contract. Contracts drafted in the shadow of these third-party influences exhibit contractual depth—the substance and structure of these contracts reflect not only the parties' intended promises communicated to an enforcing court, but also their efforts to comply with the requirements and preferences of various regulators and other third parties.

The article's new theory makes two contributions to contract law. Practically, it updates the current understanding of how parties design modern contracts. Much of the business contracting literature suggests that sophisticated parties have direct control over both contractual substance and form.[9] For contracts with depth, however, that characterization is too

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law and theory, which is the focus of this paper.

Outside of those two prior papers, the majority of contract theory is focused on courts as the audience for contracts. In a series of influential papers, for example, Albert Choi, Bob Scott, and George Triantis have discussed the various ways that parties—especially sophisticated commercial parties—design their contracts with later interpretation and enforcement by a court in mind. *See, e.g.,* Robert E. Scott & George G. Triantis, *Anticipating Litigation in Contract Design*, 115 YALE L. J. 814 (2006) (examining the efficiency of investment in the design and enforcement phases of the contracting process, and arguing that parties can lower overall contracting costs by using vague contract terms ex ante and shifting investment to the ex post enforcement phase); Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract Design*, 56 CASE WESTERN L. REV. 187 (2005) (considering the role of litigation in motivating contract design); Albert H. Choi & George G. Triantis, *Strategic Vagueness in Contract Design: The Case of Corporate Acquisitions*, 119 YALE L. J. 848 (2010) (arguing that parties can use vague contract provisions efficiently—for example, material adverse change clauses in acquisition agreements may remain vague because they are rarely litigated).

[8] At the turn of the twentieth century, the Supreme Court held, in the landmark case *Lochner v. New York*, that limits to employee working hours violated the due process clause and its inherent freedom of contract. Lochner v. New York, 198 U.S. 45 (1905). Some thirty-five years later, in *West Coast Hotel v. Parrish*, another landmark case, the Court upheld the constitutionality of a state's minimum wage legislation, ending the Lochner Era's deference to private parties' freedom of contract and opening the door to a dramatic expansion of the regulatory state. *West Coast Hotel Co. v. Parrish*, 300 U.S. 379 (1937). This, in turn, accounts for the rather unsurprising, but surprisingly overlooked, regulatory effects on contracting that have led to contractual depth.

[9] A notable exception is a strand of literature that articulates how path dependency and

simplistic. Certainly, as the literature describes, parties use contracts to engage in basic risk allocations and to communicate with courts. However, contracts also have multiple layers, each directed to meeting the requirements of various third-party audiences—and those audiences influence how and what parties can put into contracts. Through a series of original interviews with general counsels, law firm partners, and other contract designers, this article provides a first look at contractual depth in action, thereby better aligning contract scholarship with modern contracting practice.[10]

Second, this article's theory of contractual depth contributes to the long-standing parol evidence debate. The central question in the parol evidence debate is whether courts should consider extrinsic evidence when interpreting a contract.[11] Many scholars have argued that courts should take one of two interpretive routes. In one camp, there are textualists, who argue that courts should only look to the plain meaning of the contract at hand.[12] Some of the

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precedent-driven contracting practices slow the adoption of contract terms. *See, e.g.,* Eric A. Posner, Stephen J. Choi & G. Mitu Gulati, *The Dynamics of Contract Evolution*, 88 N.Y.U. L. Rev. 1 (2013) (describing how parties draft contracts by using precedent and making changes on the margins, instead of engaging in blank-page drafting and choosing terms that, in a vacuum, are the best ones); Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior and Cognitive Biases*, 75 Wash. U. L. Q. 134 (1996) (describing why parties choose not to use the most efficient contract terms).

[10] In that respect, this Article is an important contribution to contracts scholarship, which increasingly tends to address philosophical, not practical, issues. *See* Robert E. Scott, *The Promise and Peril of Relational Contract Theory,* in *Revisiting the Contracts Scholarship of Stewart Macauley* 107 (Jean Braucher, John Kidwell & William C. Whitford, eds., 2013) ("Many of the other bright stars in contract are formally trained in analytic philosophy and focus their energies on classical contract doctrine and the extent to which it adheres to deontological principles grounded in Kantian notions of autonomy.").

[11] In previous work, we have ventured into this debate. Cathy Hwang & Matthew Jennejohn, *Deal Structure*, 113 NW. U. L. REV. 279 (2018) (discussing the limits of the text/context debate in light of modular and integrated contract design). A large and vibrant body of literature, both classic and modern, also addresses this question. *See*, *e.g.*, Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Text* and *Context*: *Contract Interpretation as Contract Design*, 100 CORNELL L. REV. 23 (2014) [hereinafter Gilson, et al., *Text* and *Context*] (describing the tension between textualist and contextualist approaches to contract interpretation); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 931–32 (2010) [hereinafter Schwartz & Scott, *Contract Interpretation Redux*] (laying out some basic differences between textualist and contextualist interpretation regimes); Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 YALE L.J. 541, 544 (2003) [hereinafter Schwartz & Scott, *Limits of Contract Law*] (setting out a modern formalist/textualist theory of contract law and contractual interpretation); Eric A. Posner, *A Theory of Contract Law Under Conditions of Radical Judicial Error*, 94 NW. U. L. REV. 749, 751 (2000); Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contract Interpretation*, 146 U. PA. L. REV. 533 (1998) [hereinafter Posner, *The Parol Evidence Rule*] (discussing the parol evidence rule in contract interpretation).

[12] Gilson, et al., *Text* and *Context*, supra note 11, at 25–26 (describing a textualist regime as one in which "generalist courts cannot choose to consider context").

most prominent contract theorists of our time have argued that a textualist approach makes particular sense when interpreting contracts between sophisticated parties, which have both the technical sophistication and financial means to include everything they want into a contract.[13] In the other camp are contextualists, who have argued that courts ought to consider the broader, often-unwritten context of the transaction to discern the parties' true meaning.[14] The Uniform Commercial Code, which governs many commercial transactions big and small, generally takes a contextualist approach.[15]

The theory of contractual depth supports the contextualist side of that debate and undercuts arguments for textualism, which have grown influential in recent years. Textualist arguments typically rely upon the idea that sophisticated commercial parties are more capable of ordering their affairs than courts, and therefore courts should not attempt to interpret the context of an exchange.[16] A textualist approach gives courts a minimal role, limiting the harm they can do when they stray from the plain language of a contract.[17] Textualism also allows the parties to precisely communicate their wishes to the

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[13] *See, e.g.*, Cathy Hwang, *Unbundled Bargains: Multi-agreement Dealmaking in Complex Mergers and Acquisitions*, 164 U. PA. L. REV. 1403, 1443 (2016) (noting that "[t]extualists argue that when drafting contracts, sophisticated parties make a considered decision whether to allocate more time and money to the front-end drafting costs, or whether to roll the dice on back-end litigation costs." As a result, sophisticated parties have included all of the context they need into a contract—so textualism would be their preferred mode of interpretation).

[14] Gilson, et al., *Text* and *Context*, *supra* note 11, at 25–26 (noting that "in a contextualist regime, these courts must consider it").

[15] *Id.* at 27 (noting that "As stressed by Karl Lewellyn and partially reflected in the Uniform Commercial Code . . . , many commercial parties do business in a deeply nuanced world where formal and informal understandings mix in a mélange of explicit terms and underlying practice whose joint application to the particular contract can be illuminated by the parties' course of dealings") citing U.C.C. §§ 2-202(a) cmts. 1(b), 2; 1-303 cmt. 1 (noting that "the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.").

[16] *See* Schwartz & Scott, *Limits of Contract Law*, *supra* note 11, at 547 (noting that "in contrast to the UCC and much modern scholarship, . . . textualist interpretation should be the default theory for [contracts between firms]"); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L. J. (2010).

[17] Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 758-60 (1999) (criticizing U.C.C. Article 2's incorporation of commercial norms because it "moves the meaning of explicit provisions as close as possible to the meaning of customary terms, and in so doing transforms many customary practices into quasi-mandatory standardized provisions in all contracts in the relevant market").

enforcement court, knowing that courts will interpret the written language, and only the written language.[18]

Evidence that sophisticated commercial parties design their contracts for multiple audiences challenges textualism's underlying assumption that parties are able to carefully tailor their contracts to reflect their interests. In reality, transactional attorneys must draft contract language within a dense network of institutions, which can have conflicting demands. This backdrop casts a long shadow over what remains available for private ordering. Parties' range of maneuverability in the drafting process is limited—they sometimes forgo precise allocations of risk in order to comply with a regulator's requirements.

Because contracts must speak to multiple audiences in one document, contract language also becomes more ambiguous. To adhere to textualism in these situations would undermine the courts' goal of determining parties' intent: as contract terms grow more ambiguous, a commitment to plain meaning requires courts to refuse to enforce agreements on grounds of indefiniteness,[19] and parties can no longer trust that their promises will be enforced.

The theory of contractual depth also provides courts with a framework they can use in the difficult task of interpreting modern contracts. When a court is called upon to enforce a modern agreement, an awareness of contractual depth helps them more clearly understand the contractual means that parties have selected to achieve their ends. Contractual depth also illuminates situations where a complicated agreement includes provisions that are influenced by more than one institution simultaneously. In short, it shows a judge how to understand the different layers of a contract, how they work together, and how they can be separated conceptually during contract interpretation and enforcement.

Part I sets the stage for the theory. The parol evidence debate—a tug-of-war between textualists and contextualists over whether to admit extrinsic evidence in contract interpretation—remains, after many decades, an important question in contract interpretation. But both sides make a fundamental assumption: that contracting parties write contracts for courts. And while work on relational contracts has acknowledged a second audience, the literature has, thus far, failed to recognize the labyrinthian nature of the contemporary

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[18] Schwartz & Scott, *Limits of Contract Law*, *supra* note 11, at 547 (noting that "[b]usiness firms . . . commonly prefer courts to adhere as closely as possible to the ordinary meanings of words, to apply a 'hard' parol evidence rule, and to honor 'merger clauses' (which state that the parties intended their writings to be interpreted as if it were complete)").

[19] Robert E. Scott, *A Theory of Self-Enforcing Indefinite Agreements*, 103 COLUM. L. REV. 1641, 1657-61 (2003).

regulatory framework that influences modern contract design. The expansive regulatory state casts a long shadow on private contracting, and the result is that contracts now must respond to those regulatory and other non-party demands, while simultaneously continuing to write for courts.

Part II introduces the theory of contractual depth that helps explain why modern contracts are so complex. To build the theory, this article presents evidence from original interviews conducted with practicing in-house and law firm attorneys who design contracts for a wide range of contexts. These interviews reveal the extent to which contract parties do not drive contractual changes, the extent to which regulators' preferences make their way into contracts, and, most surprisingly, the way that diverse regulations across the fifty states further complicates contracts. When contract designers need to speak to all of these parties—not just one court—contracts gain layers of meaning, with widespread ramifications for contract design, interpretation, and enforcement.

Finally, Part III explores implications of contractual depth for theory and practice. Theoretically, it shows how contractual depth changes core assumptions in contract theory. In particular, it intervenes in the long-standing debate between textualists and contextualists, and argues that, when a contract exhibits contractual depth, a contextual approach is a necessary first step for courts to understand parties' intent. Practically, this Part discusses ways to mitigate the challenges of contractual depth and complexity, and provides some initial guidance for both contract designers and adjudicators.

I. CONTRACT'S EX POST USERS: THE CONVENTIONAL UNDERSTANDING

Current contract law and theory do not, for the most part, contemplate multiple audiences in contract design. Traditionally, scholars and judges have focused on the idea that contracts are meant to communicate to one audience: a court. In recent decades, a new vein of contract theory has expanded this framework somewhat. The literature on relational contracting argues convincingly that there is a difference between formal and informal enforcement. Formal enforcement by state-sanctioned courts is what forms the backbone of American contract law. Informal enforcement relies, instead, on enforcement through informal means, such as reputational sanctions within a business or social community. Inherent in the work of relational contract theorists is the recognition of a second, non-court, audience for whom contracts are written: a community in which reputation sanctions can levied.

But even relational contracting theory's recognition of a second audience stops at only two institutions: formal law, enforced by courts, and informal social norms, enforced by the community. Modern contracts, however, are designed with many more audiences in mind. Moreover, while

relational contracting theory posits that parties can control how their commitments are enforced—formally or informally—the theory of contractual depth suggests that parties have less control. In particular, regulatory institutions and other third parties may have a voice in how parties design their contracts. Thus, while the concepts behind relational contracting theory provide much-needed expansion of traditional contract theory, they merely open the door a crack. Contractual depth builds on that foundation, and shows how the introduction of multiple audiences into contract design changes how contracts should be enforced.

The remainder of this Part proceeds as follows. Part I.A. begins by introducing a common way to think about contracts: as a means to achieve the parties' ends. Contractual incompleteness drives a wedge between what the parties want (their ends) and what they can write down (the means). This gap, in turn, keeps courts busy: when parties dispute a contract, it is up to the courts to determine the parties' ends, sometimes even when the words on the page do not reflect them well.

Part I.B then moves on to an overview of the classic parol evidence debate, which is concerned with whether courts should admit extrinsic evidence in contract interpretation. One way to understand that debate is within the framework of means and ends. In that framework, textualists are essentially arguing that courts should focus only on a narrow conception of contractual ends—only what is written on the page. Contextualists are arguing the opposite: that courts should use all available evidence to determine the parties' ends. This Part shows that both textualism and contextualism rely on the assumption that parties write contracts with a single audience—an enforcement court—in mind.

Finally, Part I.C introduces relational contract theory, which introduces the idea—revolutionary in its time—that contracts are written for a second audience: an informal enforcement community. That is, parties sometimes make promises that they intend to be enforced in a court applying formal contract law, and sometimes they make promises that they intend to be enforced informally, such as through reputational sanctions in their trading community. A crucial assumption of this perspective is that parties retain control over their choice of enforcement institution—*i.e.*, contracting parties carefully tailor their agreements so that some disputes go to litigation and others are enforced informally.

Taken together, those three sections of Part I show that contract law struggles to make room for multiple audiences. Current contract theory has a simplistic understanding of what a contract is—a straightforward tool for parties to achieve their ends. Contracts' imperfections arise entirely from parties' inability to draft perfectly complete contracts, resulting in an

interpretation problem framed entirely in terms of what courts should do to vindicate parties' roughly articulated ends. Even the introduction of a second enforcement institution—informal sanctions—serves only that central goal. Thinking outside of this box requires a materially different concept of what a contract is—and in later Parts, contractual depth introduces that new concept.

A. Contracts as Means to Parties' Ends

At the most basic level, most contracts are simple. Parties have ends they wish to achieve by cooperating with one another. Contracts are the means that make it possible to achieve parties' contractual ends.[20]

For example, suppose that two parties intend to work together to build a housing development, and to share the profits that they earn from that joint venture. The parties' hoped-for profits are their contractual ends. To achieve these ends, the parties might draft a contract with a provision requiring that one party conduct research to find a good location for the project, while the other party procures building materials to build the building. They might draft another provision that specifies that, if each party performs their part of the bargain, they will share profits fifty-fifty. That contract is the means for achieving their ends.

When deals are simple, the role of contract law and courts is straightforward. If one party interferes with the contract, thereby jeopardizing the achievement of the parties' joint ends, the interfering party is liable for breach. Say, for instance, that one party fails to conduct a search for a good location. The job of the court is to verify that failure to perform, and then require the breaching party to compensate their contractual partner according to their expectations.[21]

In many transactions, however, the process of contract design and enforcement is not so easy. Often, contractual means do not align with contractual ends.[22] In other words, contracts are not perfect devices for achieving parties' goals. Because parties cannot fully anticipate future events, agreements will be inevitably "incomplete."[23] Events will unfold that affect the

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[20] Jody S. Kraus & Robert E. Scott, *Contract Design and the Structure of Contractual Intent*, 84 N.Y.U. L. REV. 1023, 1025 (2009) [hereinafter Kraus & Scott, *Contract Design and the Structure of Contractual Intent*] (describing the difference between contractual ends, which is what the parties want to achieve, and contractual means, which is the way through which they achieve those ends).

[21] Alan Schwartz & Robert E. Scott, *Precontractual Liability and Preliminary Agreements*, 120 HARV. L. REV. 661, 701-703 (2007) (arguing that "courts have a further facilitative role: to encourage exploration of investment opportunities by protecting the promisee's verifiable reliance).

[22] Kraus & Scott, *Contract Design and the Structure of Contractual Intent*, *supra* note 20, at 1051.

[23] Robert E. Scott & George G. Triantis, *Incomplete Contracts and the Theory of Contract*

parties' common ends, but the contractual means do not clearly determine what the parties should do, or who should bear the risk.

A chestnut from first-year contracts, *Bloor v. Fallstaff*, provides an example of how contractual incompleteness creates a mismatch between the parties' ends and the contractual means they use to achieve them.[24] At the heart of *Bloor* was an exclusive dealing arrangement for beer. Ballantine, a beer company, licensed its trademark, distribution accounts, and other assets for the Ballantine beer label to Falstaff Brewing. In return, Falstaff agreed to pay Ballantine a royalty over a number of years for each barrel of Ballantine beer sold.[25] The length of the arrangement made specifying all of Falstaff's performance obligations impossible—Ballantine could not reliably forecast the economic vicissitudes, and how Falstaff should respond to them, as it sold Ballantine's beer over the years. Sure enough, as unexpected events arose over the course of the contract and Ballantine grew dissatisfied with Falstaff's performance, the parties called upon a court to determine what, exactly, Falstaff's obligations were in light of the unforeseen events that were not spelled out in the agreement.

Bloor provides an apt example of how contractual incompleteness—which is often unavoidable—can create a gap between contractual means and contractual ends. Presumably, the parties' core ends were to create a mutually beneficial multi-year arrangement by which Falstaff would sell Ballantine's beer, and Ballantine would receive a cut of the profits. If the parties had been asked, ex ante, how they would like to proceed in the face of various scenarios, they could have presumably negotiated for solutions that they could write into the contract. However, because of the duration of the contract, the parties were

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Design, 56 CASE WES. L. REV. 187 (2005) (providing an overview of the concept of contractual incompleteness).

[24] Kraus & Scott cite to another useful example: *Hunt Foods v. Doliner*, a case about the acquisition of Eastern Can Company by canned food giants Hunt Foods. Hunt Foods became concerned that, during a break in negotiations, Eastern Can would try to solicit a better outside offer. To assuage Hunt Foods' fears, Eastern Can allowed Hunt Foods to purchase, for one thousand dollars, an option to purchase the stock of Eastern Can's majority shareholder, Doliner. Eastern Can believed that the option was conditional—Hunt Foods would only be allowed to execute the option if Eastern Can did, indeed, try to solicit an outside offer. But what was written in the contract—the contractual means—was an unconditional option that Hunt Foods could execute under any circumstance. In a later dispute, a New York court agreed with Eastern Can, finding that, in essence, the contractual ends of a conditional option did not align with the contractual means of an unconditional option. The court noted that "it was possible that the parties agreed to [a written condition for the stock option], even though they did not include the condition in their written agreement." In other words, incompleteness, as Kraus and Scott predicted, drove the ends-means misalignment. See *Hunt Foods v. Doliner* 270 N.Y.S.2d 937, 939 (App. Div. 1966). *See also* Kraus & Scott, *supra* note 20, at 1049-52.

[25] Bloor v. Falstaff Brewing, Co., 601 F.2d 609, 612-13 (1979).

unable to anticipate all of the possible contingencies, resulting in an incomplete contract and a mismatch between parties' desired ends and their contractual means.[26]

B. The Question of Text or Context

What are courts supposed to do in situations where a contract is incomplete? Answering that question has been the focus of a decades-long debate that has split courts and theorists into two broad camps. On one side are textualists, who argue that courts should not use context to interpret a disputed contract. On the other are contextualists, who argue that courts should—and, indeed, must—use outside evidence to determine intent.[27]

The most fundamental question in contract interpretation is that of parol evidence: When trying to ascertain parties' intent, should courts consider evidence outside of the contract? Textualists say no: generalist courts should look only at the four corners of the contract to ascertain parties' intent. Contextualists argue the opposite: that extrinsic evidence, such as the parties' previous course of dealing and the norms of the industry in which the parties operate, can and do help courts figure out the parties' intent.[28]

Textualism is, at its core, an efficiency argument. Textualism begins with the rather uncontroversial view that there are both costs and benefits to ascertaining parties' intent ex post.[29] When the cost of ascertaining the parties'

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[26] Perhaps in part because it is hard for parties to anticipate the changes that might affect a deal during the term of a multi-year contract, many long-term sales contracts are designed as two related contracts. First, parties enter into a master agreement that specifies general terms and conditions of the agreement. This master agreement has a multi-year term, but leaves out important specifics, such as how much of the product the buyer will buy in a given year. In subsequent purchase orders, parties execute shorter-term purchase orders, in which they specify, for instance, that the buyer will purchase a certain number of products at a certain price. For a fascinating discussion of the this contracting structure, *see* Lisa Bernstein, *Beyond Relational Contracts: Social Capital and Network Governance in Procurement Contracts*, 7 J. L. ANALYSIS 561 (2016) (describing how original equipment manufacturers in the Midwest have used a mix of formal contracts, relational contracts, and other tools to build and support their business relationships).

[27] Gilson, et al., *Text* or *Context*, *supra* note 11, at 25 (setting out the basic differences between textualism and contextualism, and describing the two modes of interpretation as binary, with one excluding the other); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux*, 119 YALE L.J. 926, 931–32 (2010) [hereinafter Schwartz & Scott, *Contract Interpretation Redux*] (laying out some basic differences between textualist and contextualist interpretation regimes); Schwartz & Scott, *Limits of Contract Law*, *supra* note 11 (arguing that textualism is the appropriate way to interpret commercial contracts between sophisticated parties).

[28] For more on the debate between text and context, see *id.* and Hwang & Jennejohn, *Deal Structure*, *supra* note 11 (discussing the limits of the text/context debate in light of modular and integrated contract design).

[29] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 27, at 930 (noting that "although accurate judicial interpretations are desirable," "no interpretative theory can justify

intent becomes very high—as it is wont to do when courts engage in the expensive process of considering extrinsic evidence—the cost may outweigh the benefit. Cabining the ex post investigation to text, therefore, reduces ex post costs associated with ascertaining parties' intent.

Textualists argue that excluding extrinsic evidence is particularly efficient when the parties involved are sophisticated. A relatively new but robust line of contract law scholarship has argued that there are costs associated with both ex ante contract design and ex post contract enforcement, and that the two costs are linked.[30] When parties invest less in ex ante contract design—perhaps by drafting a vague term that leaves room for interpretation in both performance by the parties and enforcement by the courts—the expected cost of ex post enforcement increases. By contrast, when parties invest more in ex ante contract design, the expected cost of ex post enforcement decreases. Textualists argue that sophisticated parties are well aware of these trade-offs, and if they had wanted the court to consider more evidence of their bargain, they would have included that evidence in the contract.[31] Therefore, textualists argue, sophisticated parties prefer the certainty of textualism.

In addition to cabining interpretation to the text of the document, textualists also prefer that courts default to a plain meaning rule.[32] The plain meaning rule simply supposes that parties are using "standard language," and eschews the admission of extrinsic evidence to show that parties meant something else by using the standard language.[33] A contract between a law professor and a law school provides a ready example. If the contract suggested that a professor was employed for "the next year," a textualist court would likely find that, based on the plain meaning rule, "the next year" means the calendar year. In contrast, a court that admits extrinsic evidence might admit

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devoting infinite resources to achieve interpretive accuracy.").

[30] Richard A. Posner, *The Law and Economics of Contract Interpretation*, 83 TEX L. REV. 1581, 1583 (2005) (defining the cost of a contract as the ex ante negotiating and drafting costs, plus the probability of litigation multiplied by the sum of the parties' litigation costs, the judiciary's litigation costs, and judicial error costs); Scott & Triantis, *Anticipating Litigation in Contract Design*, *supra* note 7, at 836 (noting that the "resolution of this tradeoff [between front-end and back-end costs] in each contracting instance determines the parties' optimal choice between precise and vague terms").

[31] Gilson, et al., *Text* or *Context*, *supra* note 11, at 25 (noting that sophisticated parties have already "embed[ed] as much or as little of the contractual context as they wish in a written, integrated contract.").

[32] *Id.*; Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 27, at 932 (noting that a formalist or textualist interpretation "embodies a hard parol evidence rule, retains the plain meaning rule, gives presumptively conclusive effect to merger clauses [also called integration clauses], and, in general, permits the resolution of many interpretation disputes by summary judgment").

[33] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 27, at 932 (noting that the plain meaning rule "supposes the parties to be communicating in a standard language.").

evidence to suggest that in employment contracts between academics and their institutions, "the next year" refers to the next academic year, rather than the next calendar year.

Unsurprisingly, textualism is strongly associated with a hard parol evidence rule. The parol evidence rule is a substantive rule of law that states that courts "will refuse to use evidence of the parties' prior negotiations in order to interpret a written contract unless the writing is (1) incomplete, (2) ambiguous, or (3) the product of fraud, mistake, or similar bargaining defect."[34] Posner notes that there are hard and soft interpretations of the parol evidence rule, "each of which turns on the use of extrinsic evidence to determine whether any of the exceptions apply."[35] Textualists prefer a hard parol evidence rule that "restricts courts to a narrow evidentiary base when identifying the contract's terms."[36]

In contrast, contextualists argue that courts should consider extrinsic evidence in interpreting a contract.[37] Contextualists argue that this makes sense both when dealing with contracts between parties of even and uneven bargaining power. When there is uneven bargaining power, contextualists argue that admitting extrinsic evidence protects less sophisticated parties from exploitation. When parties are evenly matched, as in many contracts between sophisticated parties, parties may be communicating in industry-standard terms that are not easily discernable through a plain-meaning, textualist reading of the contract. Contextualists' argument also rests on efficiency: they argue that "willfully restricting a court's access to the trove of information bearing on the parties' real relationship degrades judicial interpretation and frustrates the parties' efforts to govern their transactions efficiently."[38]

Contextualists prefer a soft parol evidence rule, which uses extrinsic evidence to determine whether the exceptions to the parol evidence rule apply.[39] For example, one exception to the parol evidence rule is that extrinsic evidence can be used to explain terms when a contract is deemed incomplete. Under a hard parol evidence rule, if a contract is complete "on its face"—for example, if it is long and detailed, covers many contingencies, and contains an integration clause that states that the contract is complete—then courts will not admit extrinsic evidence.[40] In contrast, contextualists might not presumptively

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[34] Posner, *The Parol Evidence Rule, supra* note 11.

[35] *Id.*

[36] Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 27, at 932.

[37] Gilson, et al., *Text* or *Context*, *supra* note 11, at 27.

[38] *Id.*

[39] Posner, *The Parol Evidence Rule*, *supra* note 11, at 534.

[40] *Id.* (citing E. ALLAN FARNSWORTH, CONTRACTS, § 7.3, at 474 (2d ed. 1990)) (noting that "[t]he harder courts declare a writing complete if it looks complete 'on its face.' Writings generally look complete if they are long and detailed, or at least contain unconditional

declare such a contract complete, and rather may look for extrinsic evidence that suggests that the contract is incomplete.[41] Eric Posner notes that "[i]n practice, . . . courts adopting this soft version of the completeness exception generally admit all relevant extrinsic evidence, because any inconsistent extrinsic evidence suggests that . . . the contract is incomplete."[42]

C. From One Audience to Two

While textualists and contextualists disagree on whether a court should use extrinsic evidence to determine parties' intent, they seem to agree on one thing: that a *court* is doing the work of determining parties' intent. Thus, the parol evidence debate has been waged largely in the terms of judicial opinions. The differences between two jurisdictions—New York and California—are often used to frame the debate.[43]

Formal enforcement, however, is not the only form of enforcement available for contracting parties. In recent decades, a new strand of contract theory has emerged that considers a second potential audience: informal enforcers. This expands the number of institutions enforcing agreements from one to two. Now contracts can be enforced through formal contract law or informal commercial norms.

This line of research begins with Stewart Macauley's and Ian Macneil's respective research on what is known as "relational contracting."[44] Macauley

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language, cover many contingencies, or at least the most important contingencies, and contain a clause, such as a merger clause, which says that the contract is complete.").

[41] *Id.*

[42] *Id.*

[43] Geoffrey Miller, *Bargains Bicoastal: New Light on Contract Theory*, 31 CARDOZO L. REV. 1475 (2010) (comparing New York and California contract law and finding support for sophisticated parties' preference for textual interpretation because sophisticated contracting parties tend to choose New York as the choice of law and forum in their contracts); Schwartz & Scott, *Contract Interpretation Redux*, *supra* note 27, at 928 (noting that New York courts tend to take a textualist approach while California courts tend to take a more contextualist approach); see also Bionghi v. Metro. Water Dist., 83 Cal. Rptr. 2d 388, 393 (Ct. App. 1999) (noting that in California, as a default, extrinsic evidence is admissible when "the language of the contract is reasonably susceptible to the meanings urged by the parties," in light of "any evidence offered to show that the parties' understanding of words used differed from the common understanding").

[44] Stewart Macauley, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (showing, through interviews of businesspeople, that although businesspeople seldom draft complete contracts, they also rarely use legal sanctions to adjudicate disputes when they inevitably arise); Ian R. Macneil, THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS (1982) (describing the norms that underlie modern relational transactions and arguing that relational contracts are everywhere); Ian R. Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical, and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978). *See also* Ian R. Macneil, *Relational Contract: What We Do and Do Not Know,* 1985 WIS. L. REV. 483. *See also* Charles J. Goetz & Robert E. Scott,

and Macneil identified transactions where the parties did not plan on enforcing their contractual commitments with contract law and the formal court system.[45] Rather, parties who entered into these "relational contracts" relied upon informal enforcement institutions, such as reputational sanctions either professionally or socially.[46]

Suppose the parties in *Bloor*, the beer distribution case, had been subject to informal, rather than formal, sanctions. If Ballantine and Falstaff had expected to continue dealing with one another after the term of their contract ended, then the threat of terminating the relationship for good might prevent one of them from breaching the agreement.[47] The hope of keeping repeat business would keep them in line. Relatedly, if they operated within a network of other companies in the beer industry, then spreading word of poor performance in the network may also make them think twice before breaching. Negative gossip disciplines the contractual parties.

Additional examples of informal enforcement abound, but perhaps the best-known example is Lisa Bernstein's, in which she describes the informal enforcement that governs New York City diamond traders, most of which are culturally homogenous.[48] Bernstein and other scholars, too, have described

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Principles of Relational Contracts, 67 Va. L. Rev. 1089 (1981) (describing the at-the-time newly developed concept of relational contracting); Barak Richman, STATELESS COMMERCE: THE DIAMOND NETWORK AND THE PERSISTENCE OF RELATIONAL EXCHANGE (2017) (describing the informal trading networks of the New York diamond industry and other ethnic trading networks that sell goods based on trust and community enforcement).

[45] *Id.*

[46] *Id.*

[47] Victor Goldberg's careful analysis of the *Bloor v. Falstaff* facts indicates that the parties expected precisely the opposite—that the deal would be a one-shot sale of assets, because Ballantine was exiting the market—and therefore this informal sanction was unavailable in the actual relationship. Victor P. Goldberg, *In Search of Best Efforts: Reinterpreting Bloor v. Falstaff*, 44 ST. LOUIS UNIV. L. J. 1465, 1466 (2000). *See also* Iva Bozovic & Gillian K. Hadfield, *Scaffolding: Using Formal Contracts to Build Informal Relations in Support of Innovation*, 2016 WIS. L. REV 981 (describing the process by which companies used formal contracts, combined with relational tools, such a threat of terminating the relationship, to motivate performance).

[48] Lisa Bernstein, *Opting Out of the Legal System: Extralegal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) (studying how culturally-homogenous diamond merchants in New York City used extralegal tools to ensure performance of their contracts). *See also* Janet Landa, *A Theory of the Ethnically Homogenous Middleman Group: An Institutional Alternative to Contract Law*, 10 J. LEGAL STUD. 349 (1981) (analyzing Chinese merchant networks in southeast Asia); JANET LANDA, ECONOMIC SUCCESS OF CHINESE MERCHANTS IN SOUTHEAST ASIA: IDENTITY, ETHNIC COOPERATION AND CONFLICT (2016) (analyzing Chinese merchant networks in southeast Asia); AVNER GREIF, INSTITUTIONS AND THE PATH TO THE MODERN ECONOMY: LESSONS FROM MEDIEVAL TRADE (2006) (studying medieval Jewish trading networks).

compelling informal enforcement in industries as far-reaching as whaling,[49] pirating,[50] cotton trading,[51] and Midwest equipment manufacturers,[52] among others. The sequence of events is quite similar in all of these industries: parties enter into a contract, one party breaches, and, instead of turning to courts for formal enforcement, parties simply bad-mouth each other professionally or socially. Fear of reputational sanctions—which might mean expulsion from an important professional organization or even a country club—motivates parties to behave well, in a way that is not dissimilar to formal sanctions through a court. And while many accounts of informal enforcement involve homogenous, tightly-knit communities within which individuals have many points of social and professional contact,[53] more recent accounts have also suggested that informal enforcement can thrive even when parties do not have otherwise strong connections with each other.[54]

One of the crucial insights that Bernstein and other scholars have provided is to connect the two different types of enforcement institutions, formal and informal, with different forms of interpretation, text and context.[55] They argue that formal courts are well equipped to determine the plain meaning of written text.[56] On the other hand, understanding the context of a transaction—the unwritten practices and norms in a trading community—is best accomplished through informal institutions.[57] In other words, there is a division of labor between formal and informal institutions.

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[49] Robert C. Ellickson, *A Hypothesis of Wealth-Maximizing Norms: Evidence from the Whaling Industry*, 5 J. L. ECON. & ORG. 85 (1989) (presenting evidence of informal enforcement overtaking formal enforcement in the whaling industry).

[50] Peter T. Leeson, *An*-aargh-*chy: The Law & Economics of Pirate Organization*, 115 J. POL. ECON., 1049 (2007) (describing the extralegal systems that pirates developed to provide checks on captain predation and to "create piratical law and order").

[51] Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) (analyzing relational contracting in the cotton industry).

[52] Bernstein, *Beyond Relational Contracts*, *supra* note 26.

[53] One recent account, for example, documents the use of non-binding preliminary agreements among people in Hollywood, who operate in a tight-knit industry. Jonathan M. Barnett, *Hollywood Deals: Soft Contracts for Hard Markets*, 64 DUKE L.J. 605 (2015) (discussing the use of non-binding agreements—or "soft contracts"—in modern Hollywood filmmaking).

[54] *See, e.g.,* Bozovic & Hadfield, *Scaffolding*, *supra* note 47 (describing the existence of informal contracting amongst both innovative and traditional businesses in Southern California).

[55] Bernstein, *Beyond Relational Contracts*, *supra* note 26.

[56] *Id.*

[57] Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy*, *supra* note 17; Schwartz & Scott, *Limits of Contract Law*, *supra* note 11.

That insight leads to a key normative implication: If that efficient division of labor is to exist, courts must stay in their lane, so to speak, by using a textualist interpretive approach. When courts wade into the *context* of a transaction, they risk misinterpreting the often nuanced and idiosyncratic practices of a market.[58] That can have lasting, negative effects on a market, because that judicial misinterpretation is public and precedential. Participants in the market have to ask themselves whether they should keep following the informal practice and risk having a court misunderstand what they are doing. In that respect, judicial analysis of a transaction's context can interfere with the operation of efficient informal institutions.

Relatedly, maintaining the division between formal contract law and informal social norms allows parties to maintain control of when they want their promises to be enforced by one or the other. If parties know that courts will only interpret the plain meaning of an agreement, and any implicit promises will be enforced informally, then they can select between formal and informal institutions by simply putting obligations they want formally enforced into the terms of the written contract and leaving out any obligations they want to enforce informally.[59]

In short, the relational contracting literature presents a new institutional framework for the text versus context debate to inhabit. After the introduction of relational contracting, the classic debate about the scope of the parol evidence rule was no longer simply focused on courts. Rather, the relational contracting literature made the debate a comparative one, asking whether formal or informal enforcement was better, and in what contexts.

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Part I shows that contract law struggles to make room for multiple audiences. Current contract theory assumes that contracts are simple tools—a means to achieve parties' contractual ends. The central question, then, is what an ex post adjudicator—a court or informal enforcer—should consider when trying to vindicate parties' contractual ends. This parol evidence debate has dominated contract theory for some time. But both sides of the debate have overlooked the fact that modern contracts are written for more than one or two ex post adjudicators. Instead, modern contracts are written to satisfy many audiences. This idea of contractual depth is explored further in the next Part, and has a profound impact on both theory and practice.

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[58] Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy*, *supra* note 17.

[59] Schwartz & Scott, *Limits of Contract Law*, *supra* note 11; Klein, *supra* note 163.

II. THEORY AND EVIDENCE OF CONTRACTUAL DEPTH

Do modern contracts speak only to two audiences? Anecdotal evidence suggests that they do not. Facebook's recent privacy-policy woes, for example, suggest that a third party who is not a signatory to the privacy policy—not Facebook itself, and not an individual consumer—is involved in shaping the policy. And Facebook's situation is by no means unique: hints of third-party, non-signatory involvement in private contracting are everywhere, easily spotted but not at all explained.

This Part shows how and why third parties intervene in private contracts. In short, the administrative state, as well as other third-party influences on contracting, affect how parties draft their contracts. As a result, contract designers are required to consider more than the *parties'* intent when drafting a contract—rather, contract designers are also using the same contract to communicate and comply with third parties, from regulators to future assignees. The fact that contracts are drafted to speak to multiple audiences creates what this Article calls "contractual depth."

The remainder of this Part sets forth the theory of contractual depth. Part II.A. introduces the contours of the theory. At its core, the theory is simple: that contracts often speak to more than one audience. For a classic contract theorist, this theory upends a well-accepted assumption in contract law: that contracts create evidence for a single ex post adjudicator whose only job is to unearth the parties' original intent. For a judge, contractual depth complicates her job: it means that when reading a contract, a particular provision *may* be evidence of the parties' intent, but may also be the parties' attempt to speak about some matter of non-intent to some third-party contract influencer. In other words, the theory of contractual depth complicates the notion that the only readers of the contract are the parties and some ex post adjudicator; it introduces the complexity of additional third-party readers and users of the contract. Part II.B. then presents evidence to support this theory. In particular, it uses evidence from original, semi-structured interviews with contract designers—general counsels, law firm attorneys, and other contract negotiators—to show, specifically, how non-party and non-adjudicator parties influence the form, structure, and substance of contracts.[60]

A. How Contractual Language Gains Depth

The theory of contractual depth introduced here can be considered the latest step in a long-running development in contract law. For many decades, contract law and theory focused on formal contracts and formal enforcement—that is, the idea that parties enter into a binding contract for the

[60] For more information on interview methodology, see *infra* Part II.B.4.

purpose of having it later adjudicated by a state or federal judge.[61] The enforcement outcomes for formal contracts are familiar: reliance or expectation damages, depending on the contract. Relational contracting expanded that universe of potential ex post readers to include second group: informal enforcers.[62] Informal enforcers consist primarily of social or professional networks that can impose reputational sanctions for breach.

The theory of contractual depth introduced here is an extension of the idea that two institutions are involved in the enforcement of contracts. Instead of stopping at two institutions, contractual depth accepts the possibility that an even greater number of institutions review the terms of an agreement. It also acknowledges that those additional institutions review contractual terms with different doctrinal lenses than the ex post adjudicators who enforce contractual promises. However, the underlying trend is consistent: Contracts are not designed in a landscape dominated by a single monolithic legal institution. Rather, they are designed in a varied, complicated institutional environment. A network of institutions regulates modern contracts.

Contractual language has depth when it is written for more than one audience. In addition to a court or private tribunal called upon to enforce the parties' contractual promises, those additional audiences may include participants in secondary markets or regulatory institutions that will review the language of the agreement. Those regulatory institutions may be public or private courts applying a different set of doctrines that regulate the bargaining process, such as antitrust law or corporate law. Or they may be administrative agencies, such as the Federal Trade Commission or the Consumer Financial Protection Bureau reviewing terms under a consumer protection mandate.

Writing for multiple institutional audiences makes the language of the agreement multifaceted, or multi-layered.[63] One layer of the agreement remains the classic contract, where contractual language reflects the intentions of the parties on how to allocate risk between themselves. Subsequent layers reflect the parties' attempts to comply with third party demands, such as regulatory obligations. Of course, those subsequent layers of the agreement reflect the parties' intentions—parties intend to comply with certain regulatory obligations, for instance, rather than running afoul of the law. However, the critical point is that the different layers are often not fully separated from one another. Responding to a regulatory audience may affect the underlying risk

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[61] *See supra* Part I.B. for a more detailed discussion of formal contracting.

[62] *See supra* Part I.C. for a detailed discussion of how relational contracting expands the ex post adjudicatory audience from one (courts) to two (courts and informal enforcers).

[63] *See*, *e.g.*, Patrick Goethals, *A Multilayered Approach to Speech Events: The Case of Spanish Justification Conjunctions*, 42 J. PRAGMATICS 2204 (2010) (identifying three layers of meaning that differentiate a set of causal conjunctions in the Spanish language).

allocation between the parties, for instance. To fully understand that risk allocation, one must also appreciate the effect of the regulatory layer.

The argument that contractual language has multiple layers is one way to think about the complex notion of "intertextuality" in semiotics, which studies the communication of meaning.[64] Intertextuality refers to text being socially embedded within a wider literary system.[65] Text is a reconfiguration of other texts, and in that respect it bears within it multiple perspectives or "levels."[66] This makes the relationships between those levels the subject of interpretation, rather than focusing upon the text as an isolated artifact.[67]

Advanced literary theory, however, is not required to identify obvious examples of linguistic depth in every-day life. Disney cartoons are a good example: while ostensibly targeted toward children, they also contain numerous literary, social, and even risqué references to keep parents entertained.[68] Similarly, dialogue in movies and television are often written in anticipation of the words being translated into multiple languages.[69] Finally, a religious text may contain layers of messages, some accessible for new initiates and others so subtle that they require extensive study to uncover.[70] In all of these cases, a text is being written with multiple audiences in mind.

Many modern contracts exhibit the same multi-layered features as these everyday writings—one contract is meant to speak to multiple different audiences. As discussed in Part I.C above, others have already established that contracts can speak to formal enforcers (courts) and informal enforcers (through relational contracting), often at the same time. But modern contracts

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[64] For a useful overview of the theory of intertextuality, see GRAHAM ALLEN, INTERTEXTUALITY (2000).

[65] Maria Jesus Martinez Alfaro, *Intertextuality: Origins and Development of the Concept*, 18 ATLANTIS 268, 227 (1996). In her seminal essay on the subject, Kristeva even supplies three different definitions of the term. Julia Kristeva, *Word, Dialogue, and Novel* in DESIRE IN LANGUAGE: A SEMIOTIC APPROACH TO LITERATURE AND ART 66, 69, and 86-7 (Leon S. Roudiez ed. 1977).

[66] *Id.*

[67] Alfaro, *supra* note 64, at 268.

[68] In the Disney animated film *Hercules*, for example, one character says to another that "I haven't seen this much love in a room since Narcissus discovered himself"—a reference to Narcissus, a character in Greek mythology who was so beautiful and self-absorbed that he fell in love with his own reflection. The Walt Disney Company, *Hercules* (1997).

[69] In another scene from *Hercules,* one character declares to the titular character, "Sorry, kid. Can't help ya . . . Two words: I am retired." Of course, "I am retired" is three words, not two—but that line is a reference to the fact that Hercules is about Greek mythology, and "I am retired" in Greek is, indeed, only two words. Internet Movie Database, *Hercules Trivia*, *available at* https://www.imdb.com/title/tt0119282/trivia.

[70] *See*, *e.g.*, Olivier Simonin, *Communication and Layers of Meaning*, 33 J. OF LITERARY SEMANTICS 41, 53 (2004) (noting that layers of narration are "conspicuously used in parables").

speak to more than just two parties: they also speak to regulators, anticipated assignees, and middle managers who have to perform the contract, just to name a few.

Regulators are perhaps the most important of these parties. One of the most oft-cited adages in legal scholarship is the idea that bargains are struck "in the shadow of the law."[71] Put another way, laws and regulations provide the guardrails within which parties may privately order their affairs.[72] The classic example of bargaining within the shadow of the law is divorce: Robert Mnookin and Lewis Kornhauser, who coined the phrase "bargaining in the shadow of the law" in their 1979 article of the same name, note that "the primary function of divorce law [is] not [ ] imposing order from above, but rather providing a framework within which divorcing couples can themselves determine their post-dissolution rights and responsibilities."[73]

And, in fact, many contracts speak to regulators. In New York state, for example, a complex web of municipal housing laws leaves very little room for individual landlords and tenants to contract.[74] In fact, there is so little room for private ordering in New York City housing laws that many landlords simply use a standard-form apartment lease agreement provided by regulators, with some additional agreements contained in a rider.[75] The result of the numerous regulations is that these riders, even though limited in scope, must be designed with regulatory compliance in mind. Similarly, contracts in the banking

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[71] Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950, 968 (1979) (describing the process of divorce as private ordering within the boundaries of the law); Melvin A. Eisenberg, *Private Ordering Through Negotiation: Dispute Settlement & Rulemaking*, 89 HARV. L. REV. 638 (1979) (coining the term "private ordering" and defining it as law to which private parties themselves agree via agreement or contract).

[72] Mnookin & Kornhauser, *Bargaining in the Shadow of the Law*, *supra* note 71.

[73] *Id.* at 950.

[74] Luis Ferré-Sadurní, *How New Rent Laws in N.Y. Help All Tenants*, N.Y. TIMES, Jun. 21, 2019, https://www.nytimes.com/2019/06/21/nyregion/rent-laws-new-york.html (reporting on a the news laws passed in 2019 to protect tenants and noting that "[t]aken together, the new laws—on everything from evictions to security deposits to rent caps for residents of mobile homes—represent a significant shift in power away from landlords and cement New York's standing as a national leader of policies favorable to renters").

[75] One New York real estate website, for example, warns renters to read leases carefully, because despite recent changes to New York state laws that are substantially more tenant-friendly, "many landlords still rely upon a standard lease form, which if often designed to protect landlords." Tripp Whetsell & Donna M. Airoldi, *Renters Beware: 14 Things to Look for in that Lease*, BRICK UNDERGROUND (Jul. 16, 2019).

industry,[76] the consumer finance industry,[77] the mortgage industry,[78] and even in complex M&A must comply with federal, state, and local regulations and are therefore crafted with regulators as a potential audience.

While regulators are the most important audience member in the new framework of contractual depth, there are others, too. Contracts are often written for individuals working within a company who need to perform the agreement. In M&A, for example, contracts often include a section called the interim operating covenants, in which the target company—the company or unit that is being sold in the transaction—promises to run its business as it always has.[79] The purpose of these covenants is to prevent the target company from, for example, emptying its corporate coffers before the target company is handed over to its new owners. Contract designers—the in-house legal department and the company's outside counsel—negotiate these interim operating covenants, but do not perform them. Rather, other individuals within the company, such as accountants, actually perform the covenants and ensure that, at the time of closing, the company's financial matters are as described in

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[76] *See, e.g.,* John Crawford, *The Moral Hazard Paradox of Financial Safety Nets*, 25 CORNELL J.L. & PUBC. POL'Y 95, 101 at n. 29 (2015) (describing the scope of reforms for financial institutions that have been implemented since the financial crisis, many of which were rules written under the Dodd-Frank Wall Street Reform Act). *See also* Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010)

[77] *See, e.g.,* Christopher L. Peterson, *Consumer Financial Protection Bureau Law Enforcement: An Empirical Review*, 90 TULANE L. REV. 1057,1060-61 (2016) (noting that Dodd-Frank created a new Consumer Financial Protection Bureau, which is a "federal agency that describes itself as a '21st century agency that helps consumer finance markets work by making rules more effective, by consistently and fairly enforcing rules, and by empowering consumers to take more control over their economic lives'"), citing *The Bureau*, CFPB, http://www.consumerfinance.gov/the-bureau/.

[78] The American Bankers Association, for example, notes that:

> Over the past 9 years, the mortgage finance sector has been the focus of frequent and intense regulatory change, including extensive reformations ordered under authority of the Dodd-Frank Act. . . . The import and magnitude of this torrent of federal rules is difficult to overstate—the new regulations are sweeping and affect every aspect of mortgage lending, including modified disclosure forms and timetables, required underwriting methodologies, loan term prohibitions, limitations on fees and pricing, requirements regarding third party relationships, allowable compensation to employees, staff registration and training requirements, appraisal and valuation obligations, counseling disclosures for borrowers, servicing procedures, servicing-related prohibitions, escrow account requirements, data reporting requirements, record retention responsibilities, fair lending, and other areas.

American Bankers Association, *Mortgage Lending Rules: Sensible Reforms for Banks and Consumers* (May 2017), *available at* https://www.aba.com/Advocacy/Documents/Mortgage-Reforms.PDF.

[79] Stephen M. Bainbridge, MERGERS & ACQUISITIONS (3d ed. 2012).

the covenants. Because a non-contract designer third party actually performs these covenants, interim operating covenants are often written with them in mind. In M&As involving public companies, for example, specific financial targets are described in terms of the Generally Accepted Accounting Principles—GAAP—which is an accepted way to communicate financial information in the accounting industry.[80] Even in M&A deals involving private targets, which are not required by securities laws to prepare GAAP-compliant financial statements, contracts might still refer to GAAP, since it is the universally accepted language for accountants—the individuals who will perform the contracts.

B. Contractual Depth in Practice: Evidence from Interviews

Contractual depth is more than theoretical—for contract designers who practice in the shadow of third-party influences, it is second-nature. This Part presents evidence from original interviews with contract designers to clarify the contours of the theory. These contract designers include in-house counsel with experience in a variety of industries, from semiconductor manufacturing to energy to online services.

Together, their responses reveal several themes about contractual depth. First, they note that contract parties themselves are not always the ones driving contractual change. This is especially true for contracts between businesses and consumers, where contractual change is frequent but not driven by businesses *or* consumers. Second, interview participants often discussed the role of regulators in shaping contract design. While they also discussed the role of other third parties, such as contract performers and third-party assignees, regulators seemed to be the most important driver of contractual depth. Third, and perhaps most importantly, interview participants discussed how multiple third-party influencers can all influence a single contract, thereby creating even more complicated depth. An example of this is a contract that is used nationally and therefore needs to comply with specific regulations and requirements set by each of the 50 states. A contract like this has quirks like the inclusion of a particular California-required provision in contracts governed by New York law. The following sub-Sections discuss these findings in more detail.

1. The role of contracting parties in driving change

Several interview participants noted that parties to the contract do not always—or even often—cause changes to the contract. This is particularly true of contracts between businesses and consumers.

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[80] *Id.*

In fact, many of these interviewees emphasized that consumers were typically the audience *least* likely to affect the language of the agreement.[81] As one former general counsel of an internet company described it:

> We tried to draft the language at a seventh-grade level. We tried to draft it clear. I tried to make them shorter. If someone did read it, I wanted them to be able to read it and understand it. But we knew from our data that almost nobody clicked on the terms of the privacy policy. Customers just weren't reading them.[82]

At first glance, contracts that change without one party's input seem to be at odds with a fundamental principle of contract: that a contract reflects the parties' bargained-for exchange.[83] But, as other scholars have noted, lack of consumer involvement in these kinds of clickwrap contracts—contracts such as privacy policies and terms of service that online service providers ask consumers to sign before using their services—is well-established and well-documented in the literature.[84] In fact, not only are consumers not involved in negotiating and drafting these contracts, they also do not read them[85] and may not have the tools to understand them.[86]

Intuitively, it is not a surprise that consumers do not engage in the drafting or negotiation of clickwrap agreements. Clickwrap agreements are often full of boilerplate provisions—standard provisions that appear, often verbatim and almost by rote, across many contracts.[87] And while boilerplate can be found in many contracts, it has been particularly well-documented in

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[81] *See*, *e.g.*, Interview #1 (Dec. 18, 2018); Interview #2 (Feb. 15, 2019); Interview #3 (May 31, 2019).

[82] Interview #1 (Dec. 18, 2018).

[83] *See supra* Part I.A.

[84] Omri Ben-Shahar, *The Myth of the "Opportunity to Read" in Contract Law*, 5 EUR. REV. CONTEMP. L. 1, 13–21 (2009); Robert A. Hillman and Maureen O'Rourke, *Defending Disclosure in Software Licensing*, 78 U. CHI. L. REV. 95, 106–08 (2011); Ronald J. Mann and Travis Siebeneicher, *Just One Click: The Reality of Internet Retail Contracting*, 108 COLUM. L. REV. 984, 998–1001 (2008).

[85] David A. Hoffman & Tess Wilkinson-Ryan, *The Psychology of Contract Precautions*, 80 U. CHI. L. REV. 395, 399 (2013) (noting that "armed with evidence that consumers essentially never read licenses, contracts, or warranties, opponents of mandatory disclosure have begun to make inroads against one of the most popular regulatory approaches to voluntary transactions").

[86] Kevin Litman-Navarro, *We Read 150 Privacy Polices. They Were an Incomprehensible Disaster.* N.Y. TIMES, Jun. 12, 2019, https://www.nytimes.com/interactive/2019/06/12/opinion/facebook-google-privacy-policies.html (reporting on 150 privacy policies and noting that, for example, Facebook's privacy policy is so long that it takes nearly twenty minutes to read and is also so complex that readers need a college reading level to understand it).

[87] Mitu Gulai & Robert E. Scott, THE THREE AND A HALF MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (2012).

consumer contexts.[88] As a result, consumers might rationally believe that many clickwrap agreements contain the same information, so reading individual agreements has little marginal benefit—and without reading them, consumers have little reason to negotiate them or otherwise advocate for change. Moreover, there is much evidence to suggest that even if consumers read the agreements, they might not understand or be able to process them because they are too complex, technical, or long.[89]

But even outside of the consumer contracts context, there is ample evidence that contracts sometimes change without contracting parties' input. This is particularly surprising in the context of sophisticated-party contracting, where conventional wisdom suggests that parties have both the sophistication and means to engage in very bespoke contracting.[90]

There are many examples of sophisticated parties using boilerplate, but the best example of surprising boilerplate in sophisticated dealmaking appears in sovereign debt contracts and was first described by Stephen Choi, Mitu Gulati, and Bob Scott.[91] Sovereigns—countries—often issue sovereign bonds to raise money. In 2001, Argentina did just that, issuing over a hundred billion dollars in sovereign bonds, including to a private fund called NML Capital.[92] In the contract governing the bonds was a clause called the *pari passu* clause, promising that all of Argentina's creditors would be ranked on equal footing.[93]

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[88] Michigan Law Review held a symposium on the topic that yielded several excellent papers about boilerplate in the consumer context. *See, e.g.,* Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 MICH. L. REV. 827 (2006); Douglas G. Baird, *The Boilerplate Puzzle*, 104 MICH. L. REV. 933 (2006); and Margaret Jane Radin, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1223 (2006); Omri Ben-Shahar, *Foreward [to Boilerplate: Foundations of Market Contracts Symposium]*, 104 MICH. L. REV. 821 (2006).

[89] Douglas Baird argues, for instance, that boilerplate is just another standard product in a market selling many standardized goods—and that exploitation of consumers by companies through boilerplate is no more or less dangerous than exploitation through other product attributes. *See* Baird, *The Boilerplate Puzzle*, supra note 88. *See also* Cathy Hwang & Matthew Jennejohn, *New Research in Contractual Complexity*, 14 CAP. MARKETS L.J. 381 (2019) (providing an overview of recent work on contractual complexity, and noting that many contracts are too long, technical, or complex to be understood).

[90] Cathy Hwang, *Deal Momentum*, 65 UCLA L. REV. 376, 381 (2016) (in the context of understanding why M&A parties use non-binding contracts, noting that "M&A parties have both the means and sophistication to create binding contracts").

[91] Stephen J. Choi, Mitu Gulati & Robert E. Scott, *The Black Hole Problem in Commercial Boilerplate*, 67 DUKE L.J. 1 (2017) (discussing how some boilerplate provisions used between sophisticated commercial parties have lost all or nearly all of its meaning—a problem that the authors dub the "black hole" problem).

[92] NML Capital, Ltd. V. Republic of Argentina, 699 F.3d 246 (2d Cir. 2012)

[93] Stephen J. Choi, Mitu Gulati & Robert E. Scott, *Evolution of Intelligent Design? The Variation in* Pari Passu *Clauses* (Oct. 9, 2016 draft), *available at* https://pdfs.semanticscholar.org/5bdf/7a694bd3792ac1b8dd1c3116754ef4a6cab0.pdf

In a series of papers about the *pari passu* clause, Choi, Gulati, and Scott note that the pari passu clause is a "standard boilerplate provision common to sovereign debt contracts for nearly 200 years whose contemporary meaning was hopelessly unclear."[94] In 2011, Argentina defaulted on $103 billion worth of its bonds to NML, sparking a case between NML and Argentina that eventually wound its way to the U.S. Supreme Court.[95]

The case presented numerous oddities. First, it became clear that market participants truly had no common understanding of what the *pari passu* clause meant.[96] Second, despite the lack of common understanding, "there nonetheless was widespread agreement that the term *did not mean* what the SDNY court said it meant."[97] And, perhaps oddest of all, it was clear that *pari passu* clauses are used widely in sovereign debt contracts—even though none of the parties involved knows what they mean.[98]

Sovereign debt contracts are far from the only example of boilerplate between sophisticated parties, and there is ample evidence that these boilerplate provisions do not reflect the parties' bargained-for exchange. In the sovereign debt context, for example, it seems implausible that a provision that parties do not even understand can be the result of parties' intent—it is clear that this provision entered the contract without much thought by the parties. In other contexts, too, there is evidence of this apparently rote inclusion of certain contractual terms. In contracts governing collateralized debt, for example, indentures are sometimes filed with the wrong parties' names included, suggesting that contract drafters are simply copying from prior indentures without even changing the names.

2. Regulators as the primary third-party influencer

Overwhelmingly, interview participants reported that regulators were a very important audience for their contracts. One respondent who worked on

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(describing the pari passu clause);. Anna Gelpern, *Courts and Sovereigns in the Pari Passu Goldmines*, 11 CAP. MARKETS L.J. 1,1 (2016) (describing a case in which a sovereign debtor "promise[d] to rank its creditors *pari passu* ('on equal footing')"). In the absence of such clauses, it is common for debt to have a seniority designation, where more senior debt is paid in full before subsequent junior debt is paid. *See* Cathy Hwang & Benjamin P. Edwards, *The Value of Uncertainty*, 110 NW. U. L. REV. 283, 286 (2015) (describing debt seniority and how creditors are paid in order of seniority).

[94] *See* Choi, et al., *The Black Hole Problem*, *supra* note 91, at 6, *citing* Gulati & Scott, *The Three and a Half Minute Transaction*, *supra* note 87.

[95] NML Capital, Ltd. V. Republic of Argentina, *supra* note 92.

[96] Choi, et al., *The Black Hole Problem*, *supra* note 91, at 6.

[97] Choi, et al., *Evolution of Intelligent Design*, *supra* note 93.

[98] Mitu Gulati & Robert E. Scott, *The Costs of Encrusted Contract Terms* (Jan. 26, 2016 draft), *available at* https://web.law.columbia.edu/sites/default/files/microsites/contract-economic-organization/encrusted_boilerplate_jan_26_2016-workshop_final.pdf.

internet terms of use and privacy policies, for example, noted that internet terms of use have four audiences. Regulators were the most important audience, and judges—the single audience that most of contract law considers most important—are only second-most important:

> The least important is the consumer. The second least important are your internal constituencies. . . . The third constituency is plaintiff's lawyers and the judges that will decide those cases. And then, of course, really the only audience that mattered ultimately was the regulators, because they are the ones who can come in and either redesign your policy for you or try to shut you down.[99]

As an example, he described the Federal Trade Commission's influence on the crafting of his company's auto-renewal provision. The interview participant was general counsel of an internet company that provided subscription-based services. As with many of similar services, this company wished to have an auto-renewal provision in their contracts with consumers, which allowed the company to charge for subscription services on a recurring basis until the consumer opted out. The interview participant noted that:

> The FTC was taking the position that, as long as [auto-renewal] is disclosed and there's consent, you're okay. In other words, if you have to put the disclosure before the [consumer's] decision is technically made. So, you have to put the auto-renewal disclosure on the first page. . . . We did exactly what the FTC wanted. We always had to be aware of what the FTC was saying.[100]

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[99] Interview #1 (Dec. 18, 2018).

[100] Id. The EU's introduction of the GDPR was another common example interview participants mentioned. *See*, *e.g.*, Interview #2 (Feb. 15, 2019) (noting that the EU's "GDPR has caused quite a brouhaha among tech companies. It is hard to say you're not a company serving EU users, so our privacy attorneys have been working overtime to make sure everything is compliant. Everyone has revised their terms of service and privacy policies in light of GDPR.").

Another point interview participants made was that at times, their companies changed their terms of use and privacy policies in response to regulatory processes where a government requested or demanded user data. *See*, *e.g.*, Interview #2 (Feb. 15, 2019) ("Another area where the terms of service have been revised is with respect to data sharing with governments. This is the second company where I'm in a disruptive industry, and governments are trying to figure out how to regulate us. The government always wants all your data. We push back, but we also share data with regulators. In order to do that, we have to update the privacy policy and terms of service in order to get consent . . . . We adjust out policies going forward in order to address the regulatory change.").

Another interview respondent agreed that regulators played a huge role in contracts to which the regulators were not party, noting that internet terms of use and privacy policies were explicitly drafted for regulators:

> Privacy policies and terms of use are drafted for regulators. One of our outside counsel says that you draft these not for the consumer but for the FTC and class action plaintiffs. It is a little cynical but we're trying to draft in a way that, if you were ever subjected to an inquiry or lawsuit, you can say here is where we disclosed this clearly. There are a lot of specific things you have to deal with in terms of substance, but that takes precedence over other considerations. These would be as short as possible, but unfortunately we're trying to solve for the rights we have, copyright infringement, consumer protection laws, privacy laws. That's why we don't have readable privacy policies.[101]

Unsurprisingly, in highly-regulated industries, regulators can have a particularly large influence on companies' private contracts. For instance, in the energy industry, contracts between a utility and a power generator for the purchase of electricity are typically subject to the oversight of a state regulator. One in-house attorney described the effect of the regulator on the process of designing an agreement as follows:

> As your team is negotiating the agreement, you have to keep it consistent with the regulatory overlay. One of my tasks as the regulatory lawyer on the team was to write the advice letter to the regulator explaining how the agreement was in compliance. Specifically, these letters include a section called "Consistency with Commission Decisions" that spells out how the contract complies. The regulator would decide to approve the contract based on that advice letter.[102]

Review of publicly available advice letters in California illustrates the extent of the California Public Utilities Commission's influence on the contract design process. As a supplement to its regulations, the Commission provides standard terms and conditions for electricity purchase agreements, including those that can be modified and those that cannot.[103] The advice letters describe all of the key terms of the agreement, note specifically when the Commission's

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[101] Interview #3 (May 31, 2019).

[102] Interview #2 (Feb. 15, 2019).

[103] *See* California Public Utilities Commission AB57, AB380, and SB1078 Procurement Policy Manual (2010).

modifiable standard terms were changed, and explain how those modifications are consistent with the Commission's regulations.[104]

Another interview participant, the general counsel of an energy company, also noted that even the efforts provisions of M&A contracts would be written with regulatory oversight in mind:

> The biggest difference [between energy deals] and other kinds of transactions is the level of closing uncertainty. . . . If I'm doing a typical M&A transaction, I might have an HSR condition to closing, but I have a pretty good idea whether that's going to be a problem or not. . . . If you are highly regulated, and if it is something that the public is highly interested in, [it becomes more uncertain].[105]

Insurance is another industry where recent changes to regulation had a major impact on private contracts. Primary health insurance providers draft their policies subject to federal and state regulatory review. One interview participant, a former general counsel at a large health insurer, noted that the Affordable Care Act directly changed the substance of a previously-common termination provision in their contracts:

> The regulatory overlay definitely impacts language in the contracts, such as pricing and coverage limitations. One of the biggest issues in primary health insurance contracting is renewal. Before the enactment of [the Affordable Care Act], we had a contractual provision that allowed us to terminate the policy if claims got way out of whack. The ACA required "guaranteed renewal," and so we altered the termination provisions to comply. In general, there is an incredible amount of regulation on coverage, exclusions, pricing, and broker requirements.[106]

Some of the most complex contracting designed to address regulatory audiences is found in manufacturing.[107] Many areas of manufacturing rely upon a multi-industry trade association that provides standard quality procedures for a wide variety of markets.[108] Industry-specific trade associations then provide

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[104] *See*, *e.g.*, Southern California Edison Advice Letter 2514-E (May 16, 2011), *available at* https://www1.sce.com/NR/sc3/tm2/pdf/2514-E.pdf.

[105] Interview #7 (August 3, 2019)

[106] Interview #6 (July 8, 2019).

[107] Interview #9 (Oct. 10, 2018) (noting how class action lawsuits for products liability claims shapes the design of indemnifications provisions in automotive supply chain agreements); Interview #10 (Oct. 8, 2018) (same); Interview #12 (Oct. 11, 2018) (same).

[108] The International Organization for Standardization promulgates quality management standards followed in numerous industries. Details on the current standard, ISO 9001:2015,

additional terms that fit within that broad framework.[109] Individual original equipment manufacturers will then draft their own standard terms that fit within that industry-specific framework.[110] As a result, the contract governing a supply relationship is like a nesting doll, combining cross-industry standard terms, industry-specific standard terms, OEM-specific standard terms, and then, finally, terms customized to the particular transaction.[111]

A contracting officer at an aerospace systems supplier described a similar arrangement in defense contracting:

> The Federal Acquisition Regulations [or FAR] is the umbrella for everything the government buys everywhere. Then each agency for the government has a separate, more restrictive set of rules that use FAR as the umbrella. For instance, the Department of Defense has its set of rules called the DFAR. And then departments within an agency have an additional set of rules under that. For instance, the Air Force has its own set of rules within DFAR. And departments within the Air Force have their own rules. For instance, the Air Force's Force Material Command has rules called the FMC FAR. It is like a nesting doll. The additional layers cannot eliminate regulations from the higher layers, they can only add to them. So, as you go down the chain, it gets more and more complex.[112]

Those regulations obviously shape the contracts between the U.S. government and the prime contractors that deal with it directly. Importantly, however, those regulations also affected the contracts between the prime contractors and their sub-contractors:

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can be found at https://www.iso.org/iso-9001-quality-management.html.

[109] In automotive manufacturing, for instance, the International Automotive Task Force creates a set of standards that nest within ISO 9001:2015 for suppliers and original equipment manufacturers in the automotive industry to use. *See* International Automotive Task Force, IATF 16949: Quality Management System Requirements for Automotive Production and Relevant Service Parts Organizations, (2016). The IATF standards are used uniformly across the automotive industry. Interview #8 (Oct. 8, 2018) (noting the foundational role the IATF standards play in the industry); Interview #10 (Oct. 8, 2018) (same); Interview #11 (Oct. 10, 2018) (same).

[110] For example, Ford Motor Company's supplier manual has requirements that build upon the IATF 16949 standard, which in turn builds upon ISO 9001. *See* Ford Motor Company Customer-Specific Requirements for IATF-16949:2016 (2017), *available at* https://www.iatfglobaloversight.org/wp/wp-content/uploads/2016/12/Ford-IATF-CSR-for-IATF-16949-1May2017.pdf.

[111] *See id.*

[112] Interview #5 (June 12, 2019); Interview #11 (Oct. 10, 2018) (describing a similar effect in automotive supply chains).

> Certain terms required by the FAR will flow through from the contract between the Department of Defense and the prime contractor to the agreement between the prime contractor and the second-tier supplier. FAR has some mandatory provisions, and, whether you love them or hate them, they are non-negotiable. So, as a second-tier supplier, you might push back on certain provisions when negotiating an agreement, but the prime contractor would say, too bad, they're mandatory under FAR.[113]

The importance of regulators as an audience for contracts is novel in the contract theory literature, but also extremely prevalent in contracting practice. Antitrust provisions in M&A contracts, which are explicitly drafted with regulators in mind, are good examples.

Many major M&A deals require pre-clearance from a regulatory authority before closing. In practice, pre-clearance requires that parties apply to the Department of Justice or the Federal Trade Commission, allowing the relevant agency to review their contract and other relevant deal documents before money and property can change hands. The agencies' review of the transaction is based on whether the agencies believe that the deal will cause over-consolidation in a particular industry post-closing.

Many transactions are cleared by the government quickly and without much extra expense. Transactions between major industry players, however, are more likely to undergo a "second request" review process, in which the government requires production of and reviews numerous documents to help it determine whether the merger will result in an over-consolidation—and, if so, in what sectors or geographical areas. A second request is an expensive undertaking, and can even result in the government requiring that one party or both parties divest certain parts of their businesses to avoid that over-consolidation.

The United Airlines and Continental Airlines merger in the 2010 is one example. At the time of announcement, United was the country's third-largest carrier, and Continental was the country's fourth-largest.[114] After the $3 billion

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[113] *Id.*; see also Interview #10 (Oct. 8, 2018) (noting the constraining effect of the framework of industry standards in automotive supply chain contracting); Interview #13 (Oct. 9, 2018) (noting the ways in which suppliers and OEMs can and cannot deviate from standard terms in the automotive industry); Interview #14 (Oct. 8, 2018) (same).

[114] Press Release, The United States Department of Justice, United Airlines and Continental Airlines Transfer Assets to Southwest Airlines in Response to Department of Justice's Antitrust Concerns (Aug. 27, 2010), *available at* https://www.justice.gov/opa/pr/united-airlines-and-continental-airlines-transfer-assets-southwest-airlines-response.

merger, they would become the country's largest carrier[115] and together, the merged company was expected to result in high prices for consumers because "[t]hough the new company does not intend to raise fares, . . . one of the rationales for airline mergers is to cut capacity. . . . In addition, United and Continental will no longer be competing against each other on some routes, allowing them to save money but offering travelers fewer options."[116]

As a condition to obtaining approval for their merger, the Department of Justice required the companies to take certain actions that would reduce the over-consolidation risk: they were required to transfer some Newark Airport takeoff and landing rights, as well as some additional assets, to Southwest Airlines, another major U.S. airline.[117] In requiring this divestiture, the DOJ noted that prior to the merger, United and Continental offered competing non-stop service on several routes, and one of the largest such routes was non-stop service from Newark Airport, "where Continental has a high share of service and where there is limited availability of [takeoff and landing] slots, making entry by other airlines particularly difficult."[118] The requirement to transfer slots to Southwest, a lower-cost competitor with a smaller footprint in the New York area, "will likely significantly benefit consumers."[119]

Divestitures can seriously affect the value of one or both companies, and may cause a deal to be terminated. A major proposed merger between AT&T and Time Warner, for example, was recently nearly thwarted by antitrust authorities.[120]

As a result, contracting parties have every incentive to avoid regulator-mandated divestitures, and, at the least, to avoid having to incur the costs of the divestitures. One way parties can do the latter is by specifying within the contract what happens when the government requires a divestiture—which of the companies will be required to divest, how the divestiture will change the consideration in the deal, and so forth. And, unsurprisingly, contracting parties in deals where antitrust risk is high do just that—they specify how parties will share divestiture responsibility, costs related to antitrust review, and the like.

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[115] Jad Mouawad & Michael J. de la Merced, *United and Continental Said to Agree to Merge*, N.Y. TIMES, May 2, 2010, https://www.nytimes.com/2010/05/03/business/03merger.html.

[116] *Id.*

[117] Press Release, *supra* note 114.

[118] *Id.*

[119] *Id.*

[120] Edmund Lee & Cecilia King, *AT&T Closes Acquisition of Time Warner*, N.Y. TIMES, Jun. 14, 2018, https://www.nytimes.com/2018/06/14/business/media/att-time-warner-injunction.html (reporting that the deal had closed and that previously, the DOJ had challenged the deal. A federal district court in the state of Washington ruled in favor of the companies, which allowed the deal to close).

But in addition to specifying what happens in the event of a regulator-mandated divestiture, contracting parties take an additional step to avoid regulatory costs: they unbundle the parts of their agreement that describe their potential antitrust issues into a side agreement so that regulators do not have easy, direct access to information. The design of the antitrust portions of the M&A deal is a direct response to the fact that antitrust regulators are an anticipated audience member of the contract. M&A provisions in the main M&A contract, which is easily accessible to regulators, are written in vague terms. In contrast, side letters, which are not publicly available and which, in addition to divvying up the parties' responsibilities, reveal where the contracting parties believe their antitrust issues might lie, are much more specific.

If regulators were *not* an anticipated audience for M&A contracts, the antitrust provisions in M&A contracts would surely look different. As others have noted, sophisticated deal parties—of which parties in M&A deals are paradigmatic examples—are not only able to choose what substance to put into their contracts, but also *how* that substance is expressed. In particular, parties can choose between more rule-like or more standard-like provisions, and that choice affects both ex ante contracting cost and ex post litigation risk.[121]

Sophisticated parties can and should be very rational about the form of their provisions: provisions that are likely to be litigated or disputed ex post should be drafted as rules to reduce ex post costs, while provisions that are less likely to be disputed should be drafted as standards.[122] In fact, others have shown how sophisticated parties tailor the form of their provisions in this way: Choi and Triantis, for example, have argued that it is rational to draft high-stakes material adverse change provisions in M&A contracts as vague standards because those provisions are very rarely litigated, so it makes little sense to invest ex ante cost in making them more specific.[123]

Because M&A contracts are often disputed, conventional wisdom suggests that they should be drafted as rules, rather than standards. Anticipated regulatory oversight, and a desire to keep regulators from knowing where the parties believe their antitrust issues lie, drive parties to write antitrust provisions as vague standards.

And antitrust is not the only place where parties draft their provisions in an irrationally standard-like way because regulators are an anticipated audience of the contract. Provisions relating to national security review, too,

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[121] *See supra* Part I.B. Choi & Triantis, *Strategic Vagueness*, *supra* note 7, at 836 (describing the trade-off between front- and back-end contracting costs and the use of rules and standards to toggling between those costs).

[122] *Id.*

[123] *Id.*

are often drafted as standards, when rules would appear to make more economic sense. Under the Exon-Florio Amendment, the President of the United States is authorized to review business combinations that result in a U.S. entity being controlled by a foreign entity.[124] In practice, this means that parties involved in an M&A deal can choose, voluntarily, to seek pre-clearance from the Committee on Foreign Investment in the United States (CFIUS), a federal interagency committee that reviews transactions.[125]

During the CFIUS review process, CFIUS can require that the parties take expensive steps to mitigate national security risk, "rang[ing] from assurance letters between CFIUS and the parties . . . to complex agreements that can impose burdensome operational requirements or even require restructuring aspects of the transaction itself."[126] If a transaction is not pre-cleared by CFIUS, there can be "uncertain and potentially devasting results, including [CFIUS] requiring divestiture many years after the deal has closed."[127] Recently, for example, CFIUS required Chinese gaming company Kunlun Tech to sell Grindr, a U.S.-based gay dating app that Kunlun acquired in 2016 and 2018 without CFIUS review, because of national security concerns potentially relating to Chinese ownership of personal data.[128]

The agreement governing the $7 billion merger between autoparts makers WABCO Holdings and ZF Friedrichshafen provides another recent example.[129] Like the antitrust provisions in the United-Continental agreement, the WABCO-SF Friedrichshafen agreement's CFIUS provisions, while long, are general: they merely require both to use reasonable best efforts to obtain CFIUS approval and note in general terms the timeline and process for

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[124] U.S. Department of the Treasury, The Committee on Foreign Investment in the United States (CFIUS), *available at* https://home.treasury.gov/policy-issues/international/the-committee-on-foreign-investment-in-the-united-states-cfius (describing CFIUS and its functions).

[125] *Id.* (noting that "CFIUS is an interagency committee authorized to review certain transactions involving foreign investment in the United States ('covered transactions'), in order to determine the effect of such transactions on the national security of the United States).

[126] Latham & Watkins LLP, *Overview of the CFIUS Process* at 8, *available at* https://www.lw.com/thoughtLeadership/overview-CFIUS-process.

[127] *Id.* at 4.

[128] *U.S. Pushes Chinese Owner of Grinder to Divest the Dating App: Sources*, REUTERS, Mar. 27, 2019, https://www.cnbc.com/2019/03/27/us-pushes-chinese-owner-of-grindr-to-divest-the-dating-app-sources.html (reporting on the fact that CFIUS ordered Chinese company Kunlun to divest U.S. dating app Grindr).

[129] Agreement and Plan of Merger among Wabco Holdings Inc., ZF Friedrichshafen AG and Verona Merger Sub, dated as of March 28, 2019, *available at* https://www.sec.gov/Archives/edgar/data/1390844/000119312519089436/d726995dex21.htm

obtaining that approval.[130] In terms of each party's responsibility for complying with CFIUS in order to mitigate national security concerns, the agreement merely notes, in very few words, that neither company needs to take actions that are not pre-conditions to the closing of the deal or that would reasonably be expected to have a material adverse effect on the companies.[131]

Given the expensive and potentially devasting results of not acquiring CFIUS pre-clearance, theory predicts that CFIUS provisions in the agreement, like antitrust provisions, would be highly specific.[132] CFIUS provisions, however, are also standard-like, offering little information about how the parties will divide national security risk or share in the costs of potential divestiture or transactional restructuring—another direct result of regulatory involvement in private contracting.

3. Multiple influencers and contractual depth

Thus far, this Article has discussed how the role of regulators as an anticipated audience for contracts creates contractual depth—a feature of contracts where one contract speaks to multiple audiences. But regulators themselves are not a single additional audience—and when more than one regulator is involved, contractual depth becomes more complex.

This is especially true for contracts that must operate across multiple jurisdictions. Last year, for example, the European Union began to implement the General Data Protection Regulation (GDPR), a sweeping new law that has numerous implications for consumers' control over their personal data.[133] The adoption of GDPR in Europe meant that companies had to modify their contracts to comply with GDPR, as well as with pre-existing U.S. regulations. One general counsel of an internet company noted:

> We designed our privacy policy last year to address the GDPR, and now we have to address California's new CCPA, which comes into effect in January. Overall there is a consistency of approach [among the regulators]. But there are specific rights that must be tailored to each, so there isn't a one size fits all. This just makes the contracts longer and less readable. We try to make it as plain spoken as possible, but . . . if a regulator doesn't see the exact words they're looking for, they'll ask for it to be inserted.[134]

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[130] *Id.* at § 6.4(b).

[131] *Id.*

[132] *Strategic Vagueness*, *supra* note 7.

[133] Arjun Kharpal, *Everything You Need to Know about a New EU Data Law That Could Shake up Big U.S. Tech,* CNBC, May 25, 2018, *available at* https://www.cnbc.com/2018/03/30/gdpr-everything-you-need-to-know.html.

[134] Interview #3 (May 31, 2019).

In other words, even though the company's contracts did not directly involve any regulators as a party, regulators in both California and Europe look at the contracts to ensure compliance. If the contracts are not in compliance, regulators will intervene and ask for modifications. These contracts, even though they do not involve regulators directly, must be written with regulators in mind.

When a company has a presence across multiple states, the effect is similar:

> You have 50 states and each had their own, you know, equivalent of the FTC Act or unfair and deceptive business practice. I had to go up and sit down and meet with the attorney general of Vermont because they got really hot under the collar [regarding the risk of] financial fraud and taking advantage of older people. So, they were looking at our terms of use and privacy policy. . . . They would say, well, if you had this kind of thing in your privacy policy or your terms of service, that would make us feel better. Even though we knew that no one would read it, we'd make the change to our terms. You're just better off placating the attorney general.[135]

Another general counsel, who worked in the health insurance industry, agreed:

> Insurance contracts are often subject to the regulators of multiple states, and those states can have different processes. For example, many states have control over pricing and other terms—there, you have to file your rates and get approval. Other states are "file and use" jurisdictions, where the insurance provider files the policy with the regulator and can begin using it immediately, subject to a post hoc review process. We would deal with these multiple regulatory overlays by having a standard policy and then state-specific addenda, which were subject to the review of the respective regulators.[136]

Companies face similar issues when attempting to draft contracts that require oversight by both state and federal regulators. One interview participant, the general counsel of an energy company, discussed how state and federal regulators affected their contracts: "We do have federal versus state regulations that overlap. Every state has its own version of the EPA [Environmental Protection Act], and then the federal government has its

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[135] Interview #1.

[136] *Id.*

[industry-specific commission]."[137] He noted that these overlapping requirements introduced questions of "which governs and which preempts. In our contracts, we have to make sure we know what the state environmental agency is going to say, what the [industry-specific commission] is going to say, what the Department of Energy is going to say."[138]

Contracting across multiple jurisdictions—and therefore writing with multiple jurisdictions' regulators in mind as potential audiences of the contract—can lead not only to contractual *depth*, but contractual *complexity*. The result is often lengthy and dense contractual documents: "We keep telling the regulators that you can't tell us to make it simple and to do thirteen specific things—that's why we have 5,000-word policies."[139]

Perhaps most interestingly, contracting with multiple jurisdictions' regulators in mind leads to the existence of "phantom provisions" in contracts—provisions that respond to jurisdictions X's regulators that end up in contracts in jurisdiction Y. One interview participant, for instance, noted that one state's requirements could end up in a contract governed by another state's laws, simply because as a matter of contract production, it was too cumbersome to write separate contracts for each different jurisdiction. As a result, the provision responding to North Carolina regulators ended up in contracts across multiple provisions:

> A new law came down in North Carolina . . . We would talk to our development team and say, could we isolate to only North Carolina people? . . . But they said, you know what, it's just easier to give to everybody."[140]

At times, one state's regulatory influence on a contract can also lead to several states' convergence on the same term, similar because those who did not receive the best contract terms—consumers or regulators—would demand changes:

> We would sometimes make a change throughout [all US states], because we did not want to have a situation where we had certain standards or certain provisions that would benefit [users in] one or two states, but not everybody else. That can be used against us. It can be an unfair business practice if you're giving New York residents a perk that you're not giving

[137] Interview #7 (August 6, 2019).
[138] *Id.*
[139] Interview #3 (May 31, 2019).
[140] Interview #1.

> Iowa [residents]. So, we would roll that out across everybody.[141]

Even when several states' different regulatory requirements do not cause phantom provisions to exist in contracts, using one contract to speak to multiple regulators inevitably complicate the contract. One interview participant, for instance, reported that when an internet company's terms of use needed to respond to multiple regulators, the terms of use sometimes had multiple paragraphs in the document, each responding to a different regulator:

> We had this big long paragraph that California required, and it had to be above the signature line. But then there's the automatic renewal language that was really important to the FTC. So, we had two sets of paragraphs, and they're supposed to be in the exact same spot. So, we had to choose one of them. We finally just pulled all of the state required language out and put it elsewhere, so the automatic renewal language could go in by the signature. That's why all of a sudden there's like these three big paragraphs that show up out of nowhere in the bottom of our terms and conditions. If you're in California, one paragraph applies to you; if you're in New York, another paragraph applies to you; if you're in North Carolina, another paragraph applies to you, etc.[142]

4. A note on methodology

The findings in this Part are informed by in-depth interviews with contract designers. Contract designers include in-house and law-firm attorneys who have experience drafting contracts. Interview participants have experience in a variety of industries and in companies of varying type, size, and national/international presence.

Interviews for this Article were conducted by telephone or in-person on the dates indicated. To allow interview participants to speak more freely, we promised to report on our conversations on a no-name basis. For brevity and confidentiality, we identify each participant within the text of this Article by using a reference number.

To identify interview participants, we used a snowball sampling technique, in which we asked interview participants to introduce us to additional potential participants. A shortcoming of this method is that it is hard to obtain an unbiased sample. However, personal introductions also allow us

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[141] *Id.*

[142] Interview #1.

to gain access to interview participants who might not otherwise speak to us about their work. Interviews were semi-structured.

III. THEORETICAL AND PRACTICAL IMPLICATIONS

Contractual depth reshapes our understanding of contract law. This Part discusses the implications of contractual depth for contract design, interpretation, and enforcement.

For more than three decades, scholars of the law and economics of contracts have embraced a textualist approach to interpretation that invites minimal judicial intervention into the parties' bargain ex post. This Part cuts against that: it argues, in a nutshell, that when contracts exhibit contractual depth, contextualism becomes the only way for courts to faithfully ascertain the parties' ex ante bargain.

Part III.A returns on this article's earlier discussion of contractual means and ends. Leading scholars have convincingly argued that incompleteness—in particular, parties' inability to anticipate all the potential contingencies of a contractual relationship ex ante—drives a gap between contractual means and ends. This Article introduces another driver of this gap: contractual depth. In particular, because contracts must do more than be the means by which parties document their ends—they must speak to other audiences beyond a court—there is an even wider gap between the parties' ends and what they can write in their contract.

Part III.B shows how contractual depth undercuts key assumptions in the argument for textualism. This section begins by expanding current contract theory's two-audience framework to include many audiences. It then argues that the expansion from two to many audiences makes untenable a key assumption of textualism—that sophisticated parties have control over their agreements. Designing contracts for multiple audiences means that contracting parties do not have the level of control that textualism assumes.

Part III.C shows how parties can use contract design to recapture a meaningful level of control over their agreements. In previous work, we have discussed the role of modular contract design in improving contracts.[143] Here, this article turns again to modular design: it suggests that, in theory, modularity may alleviate some of the interpretation and enforcement problems presented by contractual depth in particular. It also discusses the limits of modularity as a solution to interpretive problems, and suggests some areas for future research.

Finally, Part III.D connects contractual depth with an important recent conversation in contract theory: renegotiation. Economists writing in this area

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[143] Hwang & Jennejohn, *Deal Structure*, *supra* note 11; Hwang, *Unbundled Bargains*, *supra* note 13.

have argued, convincingly, that parties draft their contracts with future renegotiation in mind. Contractual depth, however, complicates renegotiation, because contracts that exhibit contractual depth require multiple parties at the negotiation—and renegotiation—table. Renegotiation therefore becomes less likely, and perhaps therefore less likely to color initial negotiations, too.

A. Contractual Depth and the Gap between Contractual Ends and Means

It is well-understood in contract law and theory that contracts are the means that parties use to accomplish their economic ends.[144] As other scholars have noted, contractual incompleteness is the primary driver of the gap between contractual means and contractual ends.[145] In many contracts—especially those that last for a long time or that cover complex subject matter—contract designers simply cannot account for all of the future events and contingencies that might occur during the term of the contract. As a result, they struggle to map the words of the contract—the contractual means—onto the parties' actual intent.[146]

Contractual depth adds a friendly amendment to existing accounts. When contracts exhibit contractual depth, influencers who are not party to the agreement have a say in how contract designers write their deals. For example, an M&A agreement between a buyer and a seller might be heavily influenced by antitrust regulators. These third-party influencers impact how parties design contracts both substantively and in terms of form.

Changes to form are easy to see. Previous Parts, for example, discussed the fact that M&A contracts often refer to GAAP-compliant financial statements. Because many private companies—or even divisions of public companies—do not use GAAP-compliant financials, preparing GAAP-compliant financials represents a significant outlay. However, providing the substance—the financial numbers—in a commonly-understood form is often important for individuals within each company that must perform the contract, such as accountants.

But third-party influencers also affect the substance of contracts: they can affect what goes into a contract and what does not. Previous Parts discussed how the influence of regulators, such as antitrust regulators, cause contract parties to limit the substance of antitrust-related provisions in the M&A contract for fear of tipping off regulators about the combined business combination's potential areas of concern. Rather, the parties choose to write

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144 *See supra* Part I.A.

145 Kraus & Scott, *Contract Design and the Structure of Contractual Intent*, *supra* note 20, at 1051. *See also supra* Part I.A.

146 *See* Scott & Triantis, *supra* note 22.

vague antitrust provisions in the main contract and put details into an undisclosed side agreement.

In a way, when regulators cause parties to take provisions out of an agreement, this exacerbates the incompleteness problem that Kraus and Scott identified. The effect of antitrust regulators on M&A contracts is the perfect example. In the absence of antitrust regulatory risks, parties would have presumably preferred to include, in the main contract, a more detailed account of how they would divide antitrust risk and liability. Ideally, the parties would draft as complete a contract as possible about this matter—thereby mapping contractual means closely with contractual ends. The introduction of an antitrust regulator, however, causes them to remove those provisions from the contract—thereby increasing incompleteness and widening the gap between contractual means and ends.

Perhaps most importantly, regulators can also *add* to the substance of contracts. Numerous interview participants discussed how state regulations caused them to add provisions to terms of service.[147] When regulators and other third parties *add* to contracts, they do not introduce incompleteness—if anything, they do the opposite. However, adding to contracts also widens the gap between contractual means and ends. A contract that is drafted without third-party influences reflects only one thing: the parties' contractual ends, manifested as contractual means. A contract that speaks to many audiences, however, reflects more: While it certainly does still reflect contractual ends, it also reflects various bells and whistles that the parties have included to assuage third parties. As such, when third parties are involved, even when they do not do not exacerbate incompleteness, the gap between contractual ends and means can widen.

This new type of gap between contractual means and ends—created by additions, rather than subtractions, from the contract—has an important implication for contract enforcement. Rather than exacerbating the usual problem of incompleteness, it creates a surfeit of meaning. If anything, the agreement is not under-inclusive of meaning but rather over-inclusive.

That over-inclusiveness may create ambiguity in the contract, such that a plain-meaning approach to interpretation yields an inconclusive result. In those cases, courts turn to context—in particular, the regulatory framework under which the contract was designed—to parse the parties' intent.[148]

The ambiguity between ends and means created by over-inclusiveness results in a problem that is unlike the incompleteness-created gap. When a contract is silent on a topic—that is, incomplete—a court's ex post gap-filling

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[147] *See supra* Part II.B.

[148] *See*, *e.g.*, W.W.W. Associates v. Giancontieri, 566 N.E.2d 639 (1990).

is as likely to be wrong as it is to be right.[149] Because analyzing the business context of a transaction is typically required to fill ambiguities in an incomplete contract and is difficult for generalist courts, asking courts to take a minimalist, textualist approach to interpretation makes sense.[150] But the ambiguity we examine here is largely legal in origin. Parties are drafting their contracts to multiple legal institutions, and generalist courts are particularly *well*-suited to sorting through this sort of information. Generalist courts, with their experience adjudicating cases in a wide variety of legal domains, are well-positioned to figure out how speaking to multiple legal institutions shapes the means the parties have used to effectuate their ends. Generalist courts may struggle with interpreting the *business* context of a deal, but they excel at understanding the *legal* context, which is the kind of context created by contractual depth.

B. From Two Audiences to Many

Contractual depth also means that current contract theory's two-audience model of contract enforcement[151] does not go far enough. Contract designers do not draft their agreements with only formal courts or informal social enforcement in mind. Rather, they consider a much broader network of institutions.

Moving from two to many audiences complicates contract theory in two respects. The first is obvious: It is now important to understand how those many audiences interact. The two-audience model envisioned, for the most part, a clean division of labor between the two enforcement institutions involved—formal law is good at enforcing plain language, and informal sanctions are good at enforcing unwritten understandings between the parties.[152]

The evidence in Part II above suggests, however, that when many audiences influence a contract, the divisions between the many audiences influencing modern contracts are not so clear. Interview participants often noted that different audiences would overlap, creating situations where contractual language would have to respond to more than one institution. For example, in antitrust-related M&A provisions, the same provisions had to serve

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[149] Contract economics acknowledges court's inability to fully understand the commercial context of a transaction by differentiating between evidence of performance that is "verifiable" by a court" and evidence that is only "observable" by the parties to the contract. *See*, *e.g.*, Alan Schwartz, *The Default Rule Paradigm and the Limits of Contract Law*, 3 S. CAL. INTERDISC. L. J. 389, 394 (1993).

[150] *See* Schwartz & Scott, *Limits of Contract Law*, *supra* note 11, at 547 (noting that "in contrast to the UCC and much modern scholarship, . . . textualist interpretation should be the default theory for [contracts between firms]").

[151] For a more detailed discussion of these, *see supra* Parts I.B. and I.C.

[152] *See supra* Part I.A. and Part I.C.

as the contractual means for the parties' contractual ends, and *also* respond to regulators. This becomes even more complicated when different audiences' demands differ, creating conflicts within the institutional network that contract designers inhabit. In short, expanding the number of audiences influencing the design of a contract makes it harder to predict how those audiences will interact in any given transaction much more difficult.

Second, contractual depth unsettles a central assumption in contract theory that parties, especially sophisticated parties, have full control over both the substance and form of their contracts. This assumption of control has been the foundation on which many important points in contract theory have been made. For example, much of the literature on rules and standards assumes that parties *choose* whether to draft provisions as rules or standards. Because sophisticated parties are so good at choosing what goes into a contract and how, the argument goes, parties have also introduced all the evidence they would care to introduce into a contract, and would therefore prefer textual interpretations ex post. But contractual depth unseats that assumption, and brings to light new questions. For example, if parties do not have full control over the substance and form of their contracts, can they really use rules or standards *strategically*, as the literature suggests? And do parties really include everything they want into a contract? And do they, as a result, prefer textualism?

Another important conversation into which contractual depth intervenes is that of contractual path dependency. Many scholars have puzzled over why contract designers use certain inefficient or irrational contract provisions. Theories advanced have included plain-vanilla path dependency, but also rational decisions to elect into less efficient provisions because, for instance, those provisions have been better tested through litigation.[153]

Contractual depth suggests a different reason: perhaps parties are unable to adjust their agreements quickly in response to a new precedent as contract theory often assumes. The demands of other audiences may interfere with courts' ability to influence how parties design their contracts. Parties are enmeshed within a web of institutions, which limits their freedom to design contracts as pure reflections of their interests.

Both of those factors undermine key assumptions in the argument for textualism. The modern argument for textualism largely depends upon two interwoven ideas. First, textualism envisions a crisp division of labor between formal and informal enforcement. Second, it argues that parties can select between those two types of enforcement institutions by the way they design

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[153] Marcel Kahan & Michael Klausner, *Path Dependence in Corporate Contracting: Increasing Returns, Herd Behavior & Cognitive Baises*, 74 WASH. U. L. Q. 127 (1996) (advancing reasons for why contract parts choose to use inefficient contract provisions).

their agreement.[154] That view leads to textualism, which is viewed as the form of judicial intervention least likely to misconstrue the parties' carefully tailored agreement, which might combine aspects of formal and informal enforcement.[155] However, as discussed above, the reality is that contracts are drafted with many audiences in mind. This blurs the divisions between formal and informal enforcement, and affects the amount of control that contract designers actually have over how they draft their contracts.

That means that the concerns animating the textualist argument are not as compelling as prior scholarship has depicted. There are limits to parties' ability to carefully tailor their contracts, which makes it less likely that a generalist court is going to botch the interpretation of a finely tuned contract.

C. Modularity, Complexity, and Contract Design

Contract design provides another avenue for dealing with the issues of complexity and contractual depth. Other scholars—and us, in previous work[156]—have discussed the benefits of modularity in contract design.[157]

In general, the structure of how contract provisions are put together falls along a spectrum, with modular design on one end and integrated design on the other. A modular contract is one in which parts of the contract are separated from each other and connected through standardized connectors, so that each individual part can be easily replaced without disrupting the rest of the system.[158] Car tires are an example: they can easily be switched out without disrupting the rest of the car. On the other end of the spectrum is integrated design, where contractual provisions are thickly connected with each other and require each other to work.[159]

In previous work, we have discussed how modular design allows contract designers to make a clearer choice between a textual or contextual approach to interpretation.[160] One of us has also discussed how modular design allows multiple teams of contract designers to work on a project at the same time, and how modularity can also allow specialized areas of the law to be

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154 *See supra* Part I.B and Part I.C.

155 Schwartz & Scott, supra note 9.

156 Hwang & Jennejohn, *Deal Structure, supra* note 11.

157 *See, e.g.,* Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1176 (2006) (discussing modularity within individual contracts); George G. Triantis, *Improving Contract Quality: Modularity, Technology, and Innovation in Contract Design*, 18 STAN. J.L. BUS. & FIN. 177 (2013) (describing how modular contracts improve collaboration in creating standardized contract provisions).

158 Hwang & Jennejohn, *Deal Structure, supra* note 11, at 300-01.

159 *Id.* at 301.

160 *Id.*

separated and worked on by specialist attorneys, thereby lowering contract-drafting costs.[161]

When contracts exhibit contractual depth, making contracts modular ex ante may also help reduce overall contracting cost. In previous Parts, this article outlined a central challenge in contractual depth: it is hard, ex post, for courts to distinguish between the parts of the contract that primarily serve to memorialize the parties' bilateral agreement and the parts that parties include primarily for signaling value or regulatory compliance.

Separating the contractual ends from the compliance-related parts of the contract may help. One participant, for example, described writing terms of service in plain language in one section of the contract, and appending the required regulatory language in another section. In theory, this can help courts interpret contracts more efficiently ex post.

But using modularity to distinguish the layers of contractual depth remains, at this junction, a conceptual approach—numerous practical hurdles remain. Most obviously, it can be tricky—if not impossible—to separate regulatory overlays from contractual means. Even apparently-simple modular separations can be thwarted by logistical hurdles. For example, one interview participant noted that, as general counsel, he wanted to create different forms of the same contract for use in different jurisdictions. His business team, however, sometimes found the multiple forms to be too cumbersome as a practical matter. As a result, that company used the same form—with a provision that was dictated by only one jurisdiction's particular law—in multiple jurisdictions.[162]

A challenge for future research, then, is to consider ways to more cleanly separate (or label) the ways that contractual depth influences contractual means, with the purpose of helping to streamline interpretation.

D. Renegotiation

Contractual depth also contributes to one of the most important ideas in contract economics: contract renegotiation. At first glance, contract negotiation seems like a mundane idea: Parties execute a contract and, after time passes and their trading situations change, they revisit the terms. However, a venerable line of economics scholarship argues that the prospect of renegotiating a contract can have powerful effects on the initial design of a transaction.[163]

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[161] Hwang, *Unbundled Bargains*, *supra* note 13.

[162] Interview #1. For more on the limits of modularity in contract design, see Matthew Jennejohn, *The Architecture of Contract Innovation*, 59 B.C.L. REV. 71 (2018); Tal Kastner, *The Limits of Modularity in Contract* (August 2019 draft) (manuscript on file with authors).

[163] Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*,

In many transactions, parties must engage in what is known as "relationship-specific investment"—that is, they must make investments that are only worth their full value in that particular contractual relationship.[164] Switching those investments to a transaction with some third party would only happen at a material discount.

Relationship-specific investment is necessary for many transactions to occur. In M&A, for instance, multi-step transactions are common, and parties must each make some relationship-specific investment in order to determine whether there is a full deal to be done.[165] For example, M&A parties might do diligence on each other, or prepare financial models about how the combined company might perform after a merger. These initial investments are unrecoupable if the deal falls through, but necessary for the parties to determine, as an initial matter, if they will merge.[166]

But relationship-specific investments also render the investing party vulnerable to an opportunistic partner, who, knowing that the investing party has few good alternatives, can renegotiate the agreement once performance has started in order to secure a greater share of the contractual surplus.[167] This devious use of contractual renegotiation is often described as the "hold-up" problem.[168]

That opportunistic renegotiation of a contract can put a party in a bad spot. There are only two main tools to prevent a counterparty from engaging in hold-up. First, it can try to design a contract that has provisions that prevent the counterparty from engaging in that bad behavior. Of course, anticipating all of the ways that it can shirk its performance obligations is difficult, if not impossible, and so whatever contract one designs will inevitably be imperfect. As a result, one might use a "best efforts" provision in the agreement.[169] The attraction of such a vague standard of performance is also its weakness: ultimately, "best efforts" can only be determined after the fact, which does not ensure one will actually get the benefits of its bargain.[170]

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34 ECON. INQ. 444–463 (1996); Benjamin Klein, Robert G. Crawford & Armen A. Alchian, *Vertical* Integration*, Appropriable Rents, and the Competitive Contracting Process*, 21 J. LAW ECON. 297–326 (1978).

164 Hwang, *Deal Momentum*, *supra* note 90.

165 *See, e.g.,* Albert Choi & George Triantis, *The Design of Staged Contracting*, __ TEX. L. REV __ (forthcoming 2020) for a discussion of multi-stage contracting and relationship-specific investments.

166 *Id.*; Hwang, *Deal Momentum*, *supra* note 90.

167 Klein, et al., *supra* note 1630; Oliver Hart & John Moore, *Foundations of Incomplete Contracts*, 66 REV. ECON. STUD. 115–138 (1999); Klein, *supra* note 163.

168 Klein, *supra* note 163; Klein et al., *supra* note 163.

169 Bloor v. Falstaff Brewing, Co., 601 F.2d 609, 612-13 (1979).

170 Even a "best efforts" provision—or perhaps *particularly* a "best efforts" provision, which is ultimately a vague standard—invites shaded performance. *See* Oliver Hart & John

The second option is to forego contracting entirely and coordinate economic activity through the prerogatives of ownership. In other words, if a party cannot get comfortable with a contractual solution to the renegotiation problem, it may simply say to its counterparty that it wants to transfer the assets in their entirety rather than remain intertwined in a contractual relationship. This response, based more in ownership than contracting, is one of the leading arguments for why companies exist in the first place. A massive literature in economics, originating in Ronald Coase's seminal work and developed further by Nobel laureates such as Oliver Williamson and Oliver Hart, examines the conditions under which bringing assets within the boundaries of a single firm is a more efficient response than entering into contracts that have the threat of hold-up.[171]

The theory of contractual depth changes how we think about renegotiation in an important respect. In the contract renegotiation literature, renegotiation is often understood as a tricky problem. How can a party design a contract that prevents its counter-party from renegotiating the contract when it cannot fully foresee all of the ways the counter-party may force renegotiation? The theory of contractual depth introduces a new source of constraint on renegotiation. Renegotiation of contracts that have contractual depth requires multiple parties to come to the table—not just the parties to the contract. Instead of being a bilateral bargaining problem, renegotiation becomes a multilateral collective action problem.[172] That makes renegotiation that much more difficult to undertake.

When renegotiations are challenging, concerns over strategic ex ante behavior in anticipation of renegotiation may be overblown. Companies may be significantly less concerned about the hold-up problem that renegotiation makes possible. These ideas, however, do require scholars to significantly rethink some of the fundamental aspects of the modern theory of the firm and

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Moore, *Contracts as Reference Points*, 123 Q. J. ECON. 1, 6 (2008) (distinguishing between consummate and shaded performance, and noting that "a party is happy to provide consummate performance if he feels that he is getting what he is entitled to, but will withhold some part of consummate performance if he is shortchanged—we refer to this as 'shading'").

171 Coase's seminal paper is widely recognized as the origin of the theory of the firm literature, although the specific threat of opportunistic hold-up is conspicuously absent in the piece. R. H. Coase, *The Nature of the Firm*, 4 ECONOMICA 386–405 (1937); Ronald Coase, *The conduct of* economics*: the example of Fisher Body and General Motors*, 15 J. ECON. MANAG. STRATEGY 255 (2006). Later work would focus the field's attention on hold-up threats. Klein, et al., *supra* note 163; OLIVER E. WILLIAMSON, THE ECONOMIC INTSTITUTIONS OF CAPITALISM (1985); OLIVER E. WILLIAMSON, THE MECHANISMS OF GOVERNANCE (1996); Oliver Hart, *Hold-up, Asset Ownership, and Reference Points*, 124 Q. J. ECON. 267–300 (2009).

172 For a pioneering overview of collective action problems, see MANCUR OLSEN, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS (1965).

contract economics, which are largely animated by the hold-up problem.[173] In that respect, the theory of contractual depth introduced here opens an important new horizon in the theoretical and empirical study of the contemporary economy.

CONCLUSION

Modern contracts have "contractual depth": they speak to multiple audiences. These audiences include regulators, potential future assignees, contract performers, and others. Through interviews with contract designers, this Article shows how these third-party influencers affect both the structure and substance of contracts. This Article argues that when contracts exhibit contractual depth, courts that interpret them need to take a contextualist approach to interpretation. Contextualism allows courts to disentangle the parts of the contract that reflect the parties' intent from the parts of the contract that merely represent the parties' attempts to comply with third-party influencers.

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[173] *See* Bengt Holmstrom & John Roberts, *The Boundaries of the Firm Revisited*, 12 J. OF ECON. PERSPECTIVES 73 (1998).