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Contracts and Contract Law: Challenging the Distinction Between the ‘Real’ and ‘Paper’ Deal

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Abstract—This article examines the claim that there are two different and often incompatible ‘worlds’ within which contractual relationships can be placed—a real world created by the parties and an artificial world created by contract law and formal contract documents. This distinction, often made by sociolegal scholars, is usually accompanied by the suggestion that legal reasoning might be improved by more attention to the real world of contracting at the expense of the artificial world of documents and classical doctrine. After examining the relationship between trust and contract, the role of legal institutions in supporting agreement-making and the reasons parties might have for formalizing commercial relationships, the article argues that a sharp distinction between the real and paper deal cannot be drawn and that in many commercial agreements these must be understood as integrated phenomena, rather than wholly discrete aspects of contracting behaviour. The article then considers the capacity of contract law to respond to this finding, with particular reference to the law’s approach to uncertainty in agreements and the contextual approach to contract interpretation as developed by Lord Hoffmann in *Investors Compensation Scheme* and subsequent cases.

1. Introduction

In the case of *Balmoral Group Ltd v Borealis (UK) Ltd*, a contract dispute concerning product quality, fitness for purpose and the application of standard terms, Christopher Clarke J noted that counsel for Balmoral had argued that

there were, in effect two parallel universes: the “real world” in which the parties moved and had their being, and an artificial world created for them by their lawyers when, but only when, a dispute arose. In the real world, as he submits, none of the individuals who were doing business with each other on behalf of Balmoral and

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Borealis paid any attention to the terms and conditions that the lawyers had drafted for them ... It was only when the lawyers came on the scene that the parties were transposed to an artificial world where reliance was placed on standard terms ...¹

The claim that contracting parties inhabit two different worlds, a real one created by them and an artificial one created by the law, is becoming trite in current contracts scholarship. Commentators adopting a sociolegal perspective on contracts often contrast the 'paper deal' with the 'real deal'.² The latter, broadly speaking, is the parties' agreement as understood by the parties themselves, informed by their joint desire to achieve certain economic ends from performance, and often underpinned by expectations and norms generated from within the relationship, rather than imposed externally by the law. On the other hand, the paper deal, concerned with performance, risk and litigation planning, may often appear to be rather remote from the parties' own set of priorities.³ Similarly, litigation to resolve contract disputes tends to view the contractual relationship through the lens of failure, undertaking 'an autopsy on a corpse, not ... examining an ongoing relationship in which exchange and other motivations create a mutual need for cooperation'.⁴ Given that much domestic commercial contract law is forged out of disputes, it is unsurprising that the rules that emerge from the litigation process appear out of touch with contractual reality. Most agreements are performed without issue and of those that aren't few will end up going through the courts. Nevertheless, the legal rules have faced criticism for being predicated on an unrealistic view of contracting parties and the contracting process. Thus one aim of sociolegal analysis is to demonstrate that sole focus on the legal aspect of contractual relationships (whether at planning or dispute resolution stage) offers only a one-dimensional and potentially distorting account of very complex phenomena. Implicit, very often explicit, in some of this scholarship, is the suggestion that English contract law should develop and implement legal rules more supportive of the parties' understandings about their agreement, at the expense of lawyers' understandings. The counter reaction to this line of criticism has been the emergence of a group of scholars who do not deny the social underpinnings of transactional behaviour, but question its relevance for contract law. Such scholars argue that contract law is useful as a background framework against which planning and performance take place, but only if arranged along broadly formalist lines.⁵

¹ [2006] EWHC 1900 [339].

² S Macaulay, 'The Real and the Paper Deal: Empirical Pictures of Relationships, Complexity and the Urge for Transparent Simple Rules' (2003) 66 MLR 44–79. See also H Collins, *Regulating Contracts* (OUP, Oxford 1999) 154–7.

³ See generally I Macneil, 'A Primer of Contract Planning' (1975) 48 S Cal L Rev 627–704, 639ff.

⁴ Ibid 692.

⁵ See eg R Scott, 'The Case for Formalism in Relational Contract' (2000) 94 Nw U L Rev 847–76; J Gava, 'False Lessons from the Real Deal: Campbell, Collins and Wightman on Implicit Dimensions of Contract — Discrete, Relational, and Network Contracts?' (2005) 21 J Contract Law 182–96.

The purpose of this article is not to rehearse the debates between relational scholars and neoformalists over the design of contract law, but to explore the relationship between contracts as social and legal phenomena by examining this distinction between the 'real' and 'paper' deal. As is evident from the *Balmoral* extract, this distinction is often presented as corresponding to what is respectively *authentic* and *artificial* in commercial relationships. This idea owes much to early empirical studies of contracting behaviour which demonstrated that contractors made little use of legally enforceable contracts in their dealings and still less of litigation to resolve disputes. While this article accepts that there is certainly some warrant to criticize contract law and contract documents for 'artificiality' and irrelevance, it argues that the connection between contractual relationships and contract law is much more complex and nuanced than the 'two worlds' idea suggests. More specifically, the article examines later empirical work that supports the proposition that legally enforceable contracts, and the institution of contract law, play an important and genuine role in some contractual relationships, even if it must be accepted that the dispute resolution procedures offered by the legal institutions do not. These findings suggest that contract law will not necessarily be improved by assuming that there is an authentic agreement to be found *either* in contract documents *or* relational norms. In many cases it is not possible to draw the neat distinction between these two frameworks that this either/or approach requires. What is needed is a method of legal reasoning in contract cases which is sympathetic to the operation of formal contracts and relational norms as *integrated* phenomena. The article begins by reviewing how the two worlds idea has been presented in contract scholarship and law, before examining recent empirical work to see what light it sheds on the role of legally enforceable agreements and contract law in commercial relationships. In the final section, the article considers whether contract law is equipped to mediate between the differing normative frameworks that govern transactions between commercial parties. This final section focuses on the law's approach to uncertainty in agreements and the contextual interpretation of contracts.

A caveat: as information on business practices becomes more readily available to legal scholars it seems clear that there are few generalizations that can reliably be made about the process of commercial contracting and the approach that should be taken to resolving commercial contract disputes. Even participants in the same industry are not an entirely homogenous group, necessarily sharing an identity of interest (or even level of interest) about the shape of commercial contract law. Given this, it is unlikely that any single value provides a judicial touchstone for resolving commercial disputes in a national court, nor that any single doctrine has the capacity to navigate successfully between the competing considerations involved. Certainly this article does not attempt to argue that a single approach is possible. Rather, it offers another perspective on a complex and multi-faceted phenomenon, one that

seems to the author to have been underdeveloped in the contract law literature so far.

2. *Different Contract Worlds*

A. *Contract Behaviour*

Many strands of contract law scholarship are concerned with the gulf that seemingly exists between the legal and social aspects of making and performing agreements. The findings of early empirical studies from Macaulay⁶ and Beale and Dugdale⁷ are famous for suggesting that contract law's role in planning, facilitating and enforcing agreements between firms was marginal. The Beale and Dugdale study found that parties relied on self-help and non-contractual devices (eg investigating the reputation of contracting partners) rather than legal mechanisms when conducting business, and that there was some degree of resistance to writing informal and customary industry norms into standard contract terms and conditions.⁸ Macaulay similarly found that respondents felt excessive contract planning undermined trust, created inflexibility and was counterproductive to developing a good business relationship.⁹ While these studies alerted lawyers to the importance of socially generated norms in governing the processes of economic exchange, neither the Macaulay nor the Beale and Dugdale study found that legal measures and legally enforceable agreements were of *no relevance* to the way in which business was conducted, although the studies are often used to support claims of this kind.¹⁰ These studies largely confirmed that the choice between legal and non-legal measures in governing transactions depended on the interplay of various factors: the qualities of the contracting partner, the frequency of contracting, the economic value of the contract, the level of risk and uncertainty, and the firm's own internal management and organizational objectives.¹¹ Somewhat prophetically, the Beale and Dugdale study reported 'signs of a gradual change in attitude towards tightening up procedures and creating legally enforceable agreements'.¹² Nevertheless, the studies are usually cited to support the claim that

⁶ S Macaulay, 'Non-Contractual Relations in Business: A Preliminary Study' (1963) 28 *Am Sociol Rev* 55–67.

⁷ H Beale and T Dugdale, 'Contracts Between Businessmen: Planning and the Use of Contractual Remedies' (1975) 2 *Br J Law Soc* 45–60.

⁸ *Ibid* 59.

⁹ Macaulay (n 6) 64.

¹⁰ D Campbell, eg once referred to the 'devastating empirical finding of non-use' of contract law in business relationships: 'Reflexivity and Welfarism in the Modern Law of Contract' (2000) 20 *OJLS* 477–98, 480.

¹¹ Considered by O Williamson, *The Economic Institutions of Capitalism* (Free Press, New York 1985) ch 3; D Charny, 'Non-legal Sanctions in Commercial Relationships' (1990) 104 *Harv LR* 373–467; L Kaplow, 'Rules versus Standards: An Economic Analysis' (1992) 42 *Duke LJ* 557–629; AW Katz, 'The Economics of Form and Substance in Contract Interpretation' (2004) 104 *Col LR* 496–538.

¹² Beale and Dugdale (n 7) 51.

the importance of written contracts and contract law to business dealings is overstated.

Other empirical studies have examined how legal and non-legal norms interrelate within a commercial relationship. These studies maintain that the legal framework is effectively relegated by the parties to a severable sphere of the business relation with only limited overlap with the social and relational aspects of the agreement. For example, Lisa Bernstein used the findings from her empirical studies of dispute resolution in various commodity markets¹³ to support a distinction between the parties' use of 'relationship preserving norms' and 'endgame norms' during their agreement.¹⁴ While the commercial relationship is ongoing the parties may be flexible and conciliatory in an attempt to preserve goodwill (employing relationship preserving norms), but once the relationship breaks down (or enters the 'endgame' stage) the parties may be more willing to insist upon their legal rights and more prepared to use courts to enforce them. While Bernstein recognizes that parties may use both written contracts and extra-legal norms, she isolates the operation of these two as part of fundamentally different governance strategies, applicable to different stages of the commercial relationship.¹⁵

While these empirical studies necessarily draw upon small scale and isolated examples, they do provide evidence of effective markets operating without direct assistance from formal legal institutions and legal sanctions. On a macro level there is a growing body of literature examining the role of legal institutions in furthering economic development. Researchers have undertaken empirical studies of contract governance structures in an attempt to determine whether legal institutions are essential to economic development, or whether growth can be realized through informal relational contracting regimes, or whether some mixture of formal and informal methods is necessary.¹⁶ Of particular interest are economies which achieved startling levels of growth seemingly without reliance on either formal rules of contract law or judicial systems to enforce agreements, a phenomenon sometimes described as the 'East Asian miracle' and the 'China enigma' after the nations in which this trend of 'lawless growth' was observed.¹⁷ Japan is often regarded as the prime example of an economy which enjoyed unprecedented expansion while its legal sector shrank.¹⁸ Given the specific cultural, historical and political context of the states examined, it is undoubtedly controversial to draw from them any definitive conclusions about

¹³ See, eg L Bernstein, 'Private Commercial Law in the Cotton Industry: Creating Co-operation Through Rules, Norms and Institutions' (2001) 99 Mich L Rev 1724-90.

¹⁴ L Bernstein, 'Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms' (1996) 144 Univ Pennsylvania L R 1765-822, 1796ff.

¹⁵ Bernstein (n 13) 1781.

¹⁶ For a review and commentary on this literature, see M Trebilcock and J Leng, 'The Role of Formal Contract Law and Enforcement in Economic Development' (2006) 92 Va L Rev 1517-80.

¹⁷ F Upham, 'Mythmaking in the Rule of Law Orthodoxy' (2002) Carnegie Endowment for Int'l Peace Rule of Law Series Working Paper No. 30, 13.

¹⁸ Ibid 24.

the relationship between economic development and robust legal institutions.¹⁹ But the studies at least suggest that it cannot be assumed that the law is of central importance in facilitating trade and economic growth. The stronger conclusion often drawn from all this is that the legal institution of contract is often unnecessary, even unhelpful, to the success of commercial economic transactions. From here, it becomes easy to assert that an investigation confined to the legal aspects of making and performing commercial agreements dwells only on a relatively unimportant aspect of the process of economic exchange.

B. *Contract Theory*

Sociolegal contract theorists often assert the existence of conflicting normative systems that operate within contractual relationships. Hugh Collins for example distinguishes between three normative systems that operate within transactions: the business relation, the economic deal and the legal contract. Collins asserts that each system has its own standards for governing an agreement.²⁰ The norms created by the business relationship and economic deal will govern the agreement during performance. The significance of the legal contract is confined to when the relationship is breaking down or a party perceives some economic advantage in asserting their legal rights.²¹ Like Bernstein, Collins suggests that while trading relationships are often characterized by an amalgam of formal contract and non-contractual understandings, these effectively govern separate aspects of the relationship: one is for the 'everyday', the other is a precaution for the 'day in court'. Since the latter is relatively rare, the legal contract remains the least important aspect of the parties' relationship.

The idea that different normative standards operate within a contractual agreement owes a good deal to the ground-breaking work of Ian Macneil. Macneil drew attention to the complexity of exchange relationships and contrasted it with classical and neoclassical contract law, which tended to overstate the role of the formal legal contract in the process of exchange at the expense of other social and economic support structures. According to Macneil, classical contract law has two particular features. The first is presentation: 'a rendering of past and particularly future events or structures influencing present allocative decisions as if they were present'.²² The second is discreteness: 'the separating of a transaction from all else between the participants at the same time and before and after'.²³ By drawing out these features, Macneil became associated with a division between 'discrete'

¹⁹ Trebilcock and Leng (n 16) 1565ff.

²⁰ Collins (n 2) 128–32.

²¹ Ibid 137.

²² D Campbell, 'Ian Macneil and the Relational Theory of Contracts' in D Campbell (ed.), *The Relational Theory of Contract: Selected Works of Ian Macneil*, (Sweet and Maxwell, London 2001) 3, 39.

²³ Ibid 154.

contracts, characterized by precision, planning, bindingness and transience, and 'relational' contracts, characterized by flexibility, cooperation, party interdependence and continuity.

Although no-one has done more than Macneil to educate contract law scholars about the complex nature of economic exchange, there is some warrant for interpreting his work as pitting the reality of contractual relationships against the fabricated legal construction of 'the contract'. For example, Macneil now stresses that a separate category of discrete contracts does not exist, since all contracts display relational elements (in varying degrees). Nevertheless, he also asserts that in any contract the parties may decide to enhance the discrete norms of presentation and planning at the expense of relational norms in order to create a fictional 'as-if-discrete' contract.²⁴ The idea of 'discreteness' thus encompasses both the genuine 'one shot' deal between complete strangers who do not expect to engage in repeat trades (although Macneil maintains that even this scenario relies on relational norms to some extent), and a quality that contracting parties familiar with each other may deliberately seek to impose upon their business relationship. In governing their relationship by discrete norms the parties essentially choose artifice. The legal framework is important, if not definitional, to the as-if-discrete contract since it is one of the external forces that maintains party solidarity through the imposition of legal standards on the agreement. Macneil concedes that '[a]ll these social worlds interpenetrate each other',²⁵ but it is only the existence of the legal framework that can give meaning to the idea of an *as-if-discrete* contract since it is only within that framework that such an entity can be created and made operational. Indeed Macneil's writing on contract planning assumes that planning is almost entirely the lawyer's task. Similarly, at the stage of litigation there is little the court can do to resurrect and apply relational norms: 'the contractual relationship... has become simply a tool for securing or avoiding damages'.²⁶ This implies that the fictionality of the discrete agreement is something that is intimately connected to, even arises from, the law. Professor Scott captures the idea succinctly when he writes, 'All contracts are relational, complex and subjective. But contract law, whether we like it or not, is none of those things. Contract law is formal, simple, and... classical'.²⁷ That contracts are, first and foremost, social not legal phenomena is difficult to deny, but the relationship between these two facets of commercial relationships is complex and it arguably does a disservice to the law to regard it as occupying only a minor place in economic transactions. Nevertheless, the sociolegal critique of contract law is bolstered not only by empirical studies of contract

²⁴ The discrete norms are 'effectuation of consent' and 'implementation of planning'. Macneil maintains that the parties accentuate these norms when they want precision and focus in their dealings: *ibid* 154, 158.

²⁵ *Ibid* 331.

²⁶ Macneil (n 3) 692.

²⁷ Scott (n 5) 852.

behaviour, but also by some of the features of contract law itself (at least in its classical and neoclassical guises). This is examined in the next section.

C. Contract Law

Many examples could be given of how contract law is predicated upon, and also reinforces, an artificial view of contractual relationships. Implied terms, for example, often rely on a largely fictional reference to party consent for their justification. Here I confine myself to some brief observations concerning formal written contracts. In many contexts the documented agreement is regarded as the definitive statement of legal obligations and as constituting 'the contract'.²⁸ Although the documented agreement may require supplementation and interpretation, it is usually the case that the documents will, in large part, be the focus of the legal dispute and its resolution, particularly in commercial contexts. However, formal contractual documents have also been a focus for the criticism of artificiality. Documents are likely to be drafted by lawyers, not the parties, may contain significant gaps (either by design or by oversight), may be signed without being read or understood, and are limited in their capacity to reflect the cooperative aspects of an agreement.²⁹ While the documents may record fully negotiated and genuinely agreed terms, they may also contain standard or boilerplate provisions whose inclusion is difficult to attribute to the intentions of the parties in any meaningful sense.³⁰ In addition, recent cases have confirmed that contract terms can set the factual basis upon which the parties make their agreement. In some circumstances, therefore, the courts are willing to support the parties' attempt to create a kind of alternative legal reality to the actual reality in which they found themselves. In *Peekay Intermark Ltd v Australia and New Zealand Banking Group Ltd* Moore-Bick LJ in the Court of Appeal remarked,

There is no reason in principle why parties to a contract should not agree that a certain state of affairs should form the basis for the transaction, whether it be the case or not... Where parties express an agreement of that kind in a contractual document neither can subsequently deny the existence of the facts and matters upon which they have agreed, at least so far as concerns those aspects of their relationship to which the agreement was directed.³¹

²⁸ Collins points out that courts can usually find ways to incorporate elements of the prior oral agreement into the written deal and vice versa: (n 2) 154–7.

²⁹ '...one cannot create a co-operative attitude by writing down that such an attitude will be taken to contingencies as they arise': D Campbell and D Harris, 'Flexibility in Long-term Contractual Relationships: The Role of Co-operation' (1993) 20 JLS 166–91, 173.

³⁰ Of course, not all documents are the same. Many standard terms and conditions are drafted by trusted trade associations and industry experts, rather than lawyers. For an example from the international timber trade see W Konradi, 'The Role of *Lex Mercatoria* in Supporting Globalized Transactions: An Empirical Insight into the Governance Structure of the Timber Industry' in V Gessner (ed.) *Contractual Certainty in International Trade* (Hart, Oxford 2009) 49.

³¹ [2006] EWCA 386 [56].

This attitude relates in part to the importance the law places on objectivity in contractual agreements and also that the basis upon which a party undertakes an obligation may be part of an agreed allocation of risk which is reflected in the price charged for performance. Thus the parties may 'set the facts' in order to put their agreement on a jointly acknowledged footing. This might serve a variety of pragmatic purposes, such as providing assurance that certain things will be taken to be case, despite the future being uncertain and unknowable, and preventing the parties later generating disputes on the basis of their subjective and uncommunicated intentions. Problems naturally arise when one party asserts a different, non-documented basis for the transaction which contradicts the documented position. Courts have dealt with this through a variety of direct and indirect methods, but Moore-Bick LJ suggests that if the parties have agreed it, then the 'real world' will not be permitted to encroach upon the contractual statement of 'facts'. Similar considerations influence the legal approach to contract interpretation, where the law attaches pre-eminence to the point of view of 'reasonable persons' about what the contract means, rather than the actual contracting parties. Lord Hoffmann recognized an element of artificiality in interpretation when he wrote, extra-judicially, 'the people whose utterances have to be interpreted by the courts are often to a greater or lesser extent imaginary'.³² Thus the documents, and the law, are often formulated on the basis of a very singular view of the agreement, and of the persons who have created it.

From this examination of empirical studies, contract theory and contract law, the basis for counsel's argument in *Balmoral* about the 'two worlds' of contract becomes clear. In the remainder of this article, I question some aspects of this real/paper distinction by examining what more recent empirical studies reveal about the use of formal contracts and contract law in commercial dealings. In particular, I explore three different, albeit overlapping, aspects of the distinction between the real and paper deal: (i) the relationship between contract and trust in business dealings; (ii) the role of contract law in the planning and performance of commercial agreements; (iii) the reasons why commercial parties might attempt to formalize their agreement in legally enforceable terms. The conclusion is that the legal framework might be more significant, at least in some commercial relationships, than is often indicated in the contract law literature. However, this does not entail that a court is right to adopt a formal approach to legal reasoning in every contract case, nor that legal reasoning in contract has nothing to learn from the sociolegal critique. Rather it is suggested that drawing a blunt real/paper distinction tends to overlook that many commercial contractual relationships will display a more integrated approach. In consequence, the law must be responsive to both the relational and formal aspects of an agreement. After examining the wider significance of

³² Lord Hoffmann, 'The Intolerable Wrestle with Words and Meanings' (1997) 114 SALJ 656-74, 661.

formal contracts and contract law in commercial relationships, I consider how well-equipped contract law is, given its formalist tendencies, to manage this feature of transacting behaviour.

3. *Redressing the Balance: Multiple Worlds or Only One?*

A. *Contract and Trust*

Researchers in economics, management studies and business organizations have long displayed an interest in the governance structures used in interfirm economic transactions and have examined the place of written contracts and contract law in business dealings as part of their enquiries. Since these works are not researched from a legal perspective, they display a certain disinterest with the arrangement and aims of contract law. Some of these studies suggest that formal written documents, and contract law, play a much more significant role in the business relationship than earlier contract law based studies claimed and that contract commentators seem to take for granted.³³ While this may be viewed as just a matter of different disciplinary emphasis—researchers in business organizations may need alerting to the role of law in policing and supporting economic transactions, whereas contract lawyers may need reminding that the law isn't the whole story—the research offers a window into the complex connection between formal contracts and relational norms in commercial relationships. Importantly, it provides a view of contracting behaviour not filtered through litigation. Limiting one's field of reference to cases where the contractual agreement has failed is likely to lead to distorted conclusions about the role played by formal contracts and contract law in functioning business relationships. A deeper understanding of the place of the legal framework in business dealings can give an important steer in our attempts to improve the quality of domestic contract law, at least insofar as the law is taken to contribute to facilitating and supporting commercial agreements.³⁴

In the business organizations and management literature, the idea of relational governance is often expressed in terms of a trusting relationship between the parties.³⁵ Earlier studies examining law and business behaviour tended to adopt a 'substitutes' understanding of the relationship between

³³ See, eg Collins (n 2) 117–25.

³⁴ For a sceptical view about whether contract law can better facilitate market transactions by incorporating commercial practice, see J Gava, 'Can Contract Law Be Justified on Economic Grounds?' (2006) UQLJ 253–69.

³⁵ See, eg B Lyons and J Mehta, 'Private Sector Business Contracts: The Text Between the Lines' in S Deakin and J Michie (eds) *Contracts, Co-operation and Competition* (OUP, Oxford 1997) 43. Macneil's relational theory (or essential contract theory) does not assert that some business relationships require different treatment because they are always characterized by trust or other 'soft and cuddly' values, rather all examinations of contractual relationships must start with context: I Macneil, 'Reflections on Relational Contract Theory after a Neo-Classical Seminar' in D Campbell, H Collins and J Wightman (eds) *Implicit Dimensions of Contract* (Hart, Oxford 2003) 207.

formal contracts and trust. Insistence on a formal written contract was often interpreted as manifesting a lack of trust in a business partner, or as 'crowding out' the development of trust. The ousting of trust was thought to be detrimental given the high transaction costs associated with formal contract planning and performance monitoring measures.³⁶ Smitka, for example, examined relationships between car manufacturers and their suppliers in the Japanese auto-industry. Despite their complexity, these relationships relied neither on contract law nor vertical integration and management hierarchies as governing structures.³⁷ Instead, relationships between firms were cultivated on the basis of trust. Trust was manifest in various relational strategies developed between the parties: reliance on very long term relationships with single suppliers, beginning slowly with a gradual build up of volume; simple and brief written contracts that left many gaps; development of relationship-specific norms created by the process of interaction between manufacturers and suppliers in resolving disputes; constructing elaborate information and reputation networks, and adopting a very flexible approach to the written agreement.³⁸ As a result, recourse to law when dealing with contingencies was almost unheard of and Smitka felt able to assert that 'trust offers an effective substitute to law as a basis of contracting'.³⁹

By contrast, some more recent contributions to trust scholarship have asserted the complementary nature of contract and trust, as well as the role of legal institutions in developing and supporting trust between businesses. The main problem with this scholarship is the fluid definitions of both 'trust' and 'contract' that one encounters in the literature. These terms may be understood differently by both participants in business and scholars in their research, making it difficult to reach general and consistent conclusions about the precise relationship between the legally enforceable contract and trust. Nevertheless, this difficulty proves instructive since it demonstrates that a sharp distinction between the sphere of 'contract' and the sphere of 'trust' is not always maintained in business relationships.

An example is provided by Burchell and Wilkinson's study of contracting by firms in Britain, Germany and Italy. Respondents were asked to say what they thought trust meant. Responses tended to fall into two groups. One group associated trust with substance - honesty, reliability, openness, fairness, cooperativeness—and the other associated trust with the processes by which it was established. Experience of a contracting partner doing what he said he

³⁶ B Lyons and J Mehta, 'Contracts, Opportunism and Trust: Self-interest and Social Orientation' (1997) 21 *Camb J Econ* 239–57, 239.

³⁷ MJ Smitka, 'Contracting without Contracts: How the Japanese Manage Organizational Transactions' in S Sitkin and R Bies (eds) *The Legalistic Organization* (Sage, Thousand Oaks 1994) 91, 95.

³⁸ *Ibid* 100–4.

³⁹ *Ibid* 95. See also Lyons and Mehta (n 35) 58–62; Macaulay (n 6). Some studies prefer to use contract type as an indicator of the level of cooperation between parties, rather than the concept of 'trust'. See, eg KS Corts and J Singh, 'The Effect of Repeated Interaction on Contract Choice: Evidence from Offshore Drilling' (2004) 20 *J Law Econ Org* 230–60.

would do was the most important consideration for this latter group.⁴⁰ While this might suggest that the contract has a role in the establishment of trust between parties, it was clear that ‘contract adherence’ was not solely associated with honouring the express terms of a legally enforceable written agreement. It also incorporated ‘observing standards *and* the honouring of more informal commitments’.⁴¹ Similar difficulties of definition surround the concept of trust. Some interpret trust as incorporating both self-interested and socially oriented elements.⁴² This interpretation complicates the complements/substitutes debate. Those scholars that would regard trust as always personal, other-regarding and benevolence-based may be more likely to see contract and trust as conflicting, particularly if a narrow doctrinal-legal view of contractual obligations is taken.⁴³ On the other hand, those that perceive trust as capable of operating self-interestedly are likely to view contract and trust as complements, particularly if their conception of ‘contract’ includes obligations undertaken to a partner both formally and informally. The complements view is also supported by those who regard legal enforcement of contracts and contract law as examples of ‘institutionalized’ or ‘formalized’ trust, distinct from personal trust.⁴⁴ Under this view, formal contracts and contract law are important mechanisms for dealing with the ‘essential riskiness of [personal] trust’.⁴⁵ This kind of argument has been used to build a critique of relational theory which posits contract law as the precise mechanism by which persons not already in a trusting relationship can effectively gain the benefits of trust while maintaining a degree of personal detachment.⁴⁶ The ‘complements’ analysis can also explain the finding of one empirical study that even parties who are confident that they can rely on the benefits of personal trust in their dealings still draw up legally enforceable contracts without sensing any apparent conflict.⁴⁷

The difficulty of articulating the precise connection between contract and trust reflects the inherently contradictory nature of contractual relationships. Such relationships appear *simultaneously* cooperative and competitive.⁴⁸ Given their inevitable competitive element, some scholars have questioned whether it

⁴⁰ B Burchell and F Wilkinson, ‘Trust, Business Relationships and the Contractual Environment’ (1997) 21 *Camb J Econ* 217–37, 224.

⁴¹ *Ibid* 233. It is therefore not surprising that A Kalnins and K Mayer argue that the literature on trust and contracts has not reached consistent conclusions: ‘Relationships and Hybrid Contracts: An Analysis of Contract Choice in Information Technology’ (2004) 20 *J Law Econ Organ* 207–29, 209.

⁴² B Lyons and J Mehta (n 36) and (n 35), 52ff; C Lane, ‘The social regulation of inter-firm relations in Britain and Germany: Market rules, legal norms and technical standards’ (1997) 21 *Camb J Econ* 197–215.

⁴³ RK Woolthuis, B Hillebrand and B Nooteboom, ‘Trust, Contract and Relationship Development’ (2005) 26 *Organization Studies* 813–40, 818–9.

⁴⁴ Lane (n 42); C Lane and R Bachmann, ‘The Social Constitution of Trust: Supplier Relations in Britain and Germany’ (1996) 17 *Organization Studies* 365–95.

⁴⁵ S Deakin and F Wilkinson, ‘Contracts, Co-operation and Trust: The Role of the Institutional Framework’ in D Campbell and P Vincent-Jones (eds) *Contract and Economic Organisation* (Dartmouth, Aldershot 1996) 95, 112.

⁴⁶ D Kimel, *From Promise to Contract* (Hart, Oxford 2005) 78–80 and ‘The Choice of Paradigm for Theory of Contract: Reflections on the Relational Model’ (2007) 27 *OJLS* 232–55, 247.

⁴⁷ Woolthuis and others (n 43) 829–32.

⁴⁸ Burchell and Wilkinson (n 40), emphasis in original. See also Lane and Bachmann (n 44) 367–8.

is ever appropriate to analyse business dealings in terms of trust. For these scholars trust must, at its core, be understood as expressing personal and altruistic values. These values are fundamentally at odds with commercial relationships where it remains doubtful that one party will ever fully subjugate their own interests to benefit a contracting partner.⁴⁹ Macneil regards this dualism as a reflection of human nature. He writes, 'Man is both an entirely selfish creature and an entirely social creature, in that man puts the interests of his fellows ahead of his own interests *at the same time* that he puts his own interests first'.⁵⁰ One of the effects of this is that, as Woolthuis and others have noted, conceptualizing commercial relationships according to poles is not possible: such relationships will generally display a multi-dimensional governance strategy, relying simultaneously on norms of contract *and* trust.⁵¹ Whether these two are conflicting or mutually reinforcing, substitutes or complements, is not an issue that can be decided in the abstract, but only upon close examination of each individual commercial relationship.

The literature on trust and contract raises questions concerning the capacity of the law to achieve greater understanding of commercial relationships by proceeding on the basis that there are mutually exclusive worlds of (legal) contract and trust, that the parties will have consciously decided to emphasize either one or the other, and that legal reasoning techniques need only identify the correct world within which to situate the deal, whereupon the applicable norms for dispute resolution will become apparent. The more complex reality is that legal reasoning in contract is required to appreciate and make sense of both the competitive and cooperative character of contractual relationships. So, for example, that the parties were in a trusting relationship (the relationship displays elements of personal trust) need not lead to the conclusion that a cooperative attitude towards the agreement was always expected. Rather, the trusting relationship may provide a vital element of context which ought to affect the interpretative strategy placed upon the formal contractual scheme. It is unlikely that 'trusting' parties use a formal contract to determine in absolute terms their legal rights and obligations. Instead, the documents may perform a variety of more nebulous functions designed to harness the trusting relationship and transform it into a productive one. By paying attention to this issue of role, a court is more likely to come to a decision that genuinely reflects the 'reasonable expectations of the parties' (understood in a non-legal sense), rather than one which champions the operation of one distinct value over its competitor. This point is considered further in part C of this section below, and in section 4.

⁴⁹ See O Williamson, 'Calculativeness, Trust and Economic Organization' (1993) 36 *J of Law and Econ* 453–86, 484; Burchell and Wilkinson (n 40) 219.

⁵⁰ Campbell (n 22) 153, emphasis in original.

⁵¹ Woolthuis, Hillebrand and Nooteboom (n 43) 835–6.

B. *The Role of Legal Institutions in Commercial Relationships*

Although precise analysis of the role attributed to the written form of contract within the trust literature is to an extent hampered by inadequate distinctions between 'contract' and 'trust', there are studies that have undertaken an examination of the specific function of contract law and formal written contracts in business agreements. Some of these studies have supported the argument that formal contract measures do not crowd out relational norms such as trust or cooperation but assist with their development. The study by Arrighetti, Bachmann and Deakin analysed the phenomenon of 'inter-firm cooperation' occurring through the mechanism of contractual networks or 'hybrids'.⁵² Such arrangements take a variety of forms but are usually characterized as long-term with expectations of risk sharing and free exchange of information and expertise. The study focussed on the mining machinery and kitchen units manufacturing industries in the UK, Italy and Germany. Respondents were questioned as to the prevalence of written contracts as a planning and incentive tool. Although a few firms (especially in the UK) reported little use of written contracts, preferring 'gentlemen's agreements' and letters of comfort, this attitude was not common. The authors found that 'the vast majority of firms saw both the use of writing and the attachment of legal force as important means of clarifying the agreement and providing for security in the event of a dispute'.⁵³ The security of legal enforceability was thought important even though few respondents envisaged litigation as a way of resolving problems. Contrary to Macaulay's 1963 study, which explained lack of recourse to law amongst businesses as manifesting a desire not to interfere with trust, Arrighetti and others found that use of formal contracts was compatible with reluctance to use courts. Somewhat counterintuitively, the authors discovered that use of looser commitments, particularly based on interpersonal relationships, could often be a source of disputes. They found that UK firms that placed less emphasis on planning contract performance were more likely to have to use courts to enforce agreements⁵⁴ and that recourse to courts was often the first resort in relation to payment disputes.⁵⁵ The authors concluded that it was in fact participants' knowledge of law and legal processes that made recourse to law unnecessary and that formal institutions, including commercial law, could be a method of channelling contractor behaviour, setting standards and providing incentives for maintaining stable, long-term relations.⁵⁶ In the light of these findings, Deakin seems correct to

⁵² A Arrighetti, R Bachmann and S Deakin, 'Contract Law, Social Norms and Inter-firm Co-operation' (1997) 21 *Camb J Econ* 171–95.

⁵³ *Ibid* 186.

⁵⁴ *Ibid* 191.

⁵⁵ *Ibid* 187–8. The Beale and Dugdale study (n 7) made similar findings.

⁵⁶ *Ibid* 189. L Poppo and T Zenger also support the view that contracts and relational governance function as complements. They argue that precise specifications included in written contracts reduce risk which in turn can encourage cooperation: 'Do Formal Contracts and Relational Governance Function as Substitutes or

suggest that use of formal contract law and legal mechanisms are a way of building trust between parties,⁵⁷ and to express doubts over the assumption that the law plays a diminished role in contractual relations as trust develops.⁵⁸

Similarly, Johnson, McMillan and Woodruff have undertaken a more direct study of the relationship between legal institutions and contracting practice.⁵⁹ Their study examined the level of trade credit offered (as an indication of the level of trust) to participants in business in Eastern European former soviet bloc countries, which were taken to have 'weak courts'. They argue that even in locations with weak courts, law can encourage firms to take on new contracting partners, thus fostering new relationships, although courts become less important as the relationship develops: 'it is by making it easier for new firms to enter [contracts] that having workable courts improves on relational contracting and boosts overall productivity'.⁶⁰ The background threat of possible legal action is an important motivation for the contracting parties. While traders may not make much use of national litigation schemes, they evidently make some use of the reassurance provided by the availability of legal enforcement.⁶¹

Macaulay has questioned studies that suggest a more significant role for contract law in market economies. He argues that they only demonstrate that contract law has a function in a 'limited subset of cases'.⁶² It is no doubt true that there is an identifiable 'subset of cases' which evince greater dependence on formal legal regulation. In many contractual contexts, charter markets for example, the broad understanding of participants may be that legal rights can be invoked when it becomes economically advantageous to do so, even if little importance is placed on those rights in the day to day performance of the agreement.⁶³ Similarly the financing of international trade involves complex networks of participants who rarely meet face to face and whose obligations are

Complements?' (2002) 23 Strategic Manage J 707–25, 721. Similarly, FB Cross has concluded that law may have a positive effect on trust development by giving legal assurances and remedies for breach of trust in some cases: 'Law and Trust' (2005) 93 Geo LJ 1457–546.

⁵⁷ S Deakin, 'Learning about Contracts: Trust, Cooperation and Contract Law' in R Bachmann and A Zaheer (eds) *Handbook of Trust Research* (Edward Elgar, Cheltenham 2006) 218, 227. See also S Deakin, C Lane and F Wilkinson, 'Contract Law, Trust Relations, and Incentives for Co-operation: A Comparative Study' in S Deakin and J Michie (eds) *Contracts, Co-operation and Competition* (OUP, Oxford 1997) 105.

⁵⁸ Deakin, *ibid* 228.

⁵⁹ S Johnson, J McMillan and C Woodruff, 'Courts and Relational Contracts' (2002) 18 J Law Econ Org 221–77.

⁶⁰ *Ibid* 222–3.

⁶¹ Konradi (n 30) 77.

⁶² Macaulay (n 2) 60.

⁶³ See eg, *Scandinavian Trading Tanker Co AB v Flota Petrolera Ecuatoriana (The Scaptrade)* [1983] 1 QB 529. The Court of Appeal determined that relief against forfeiture was not available to a charterer when the shipowner sought to withdraw the ship for non-payment in order to take advantage of a rising market. Although the shipowner had previously accepted late payments of hire, Robert Goff LJ observed that, 'The possibility that shipowners may snatch at the opportunity to withdraw ships from the service of time charterers for non-payment of hire must be very well known in the world of shipping' (540). The ruling was affirmed by House of Lords at [1983] 2 All ER 763.

invoked or discharged with the delivery of formal documents.⁶⁴ In these kinds of cases the law is probably correct to assume the parties' agreement is more discrete than relational, and that the parties expect disputes to be resolved by the application of formal rules via the process of litigation. Nevertheless, we should resist the temptation to assert that outside these contexts the law has little relevance and influence. None of the studies considered in this section should be taken as casting doubt on the importance of relational norms in agreement formation and performance. But they do cast doubt on the blanket assertion that reliance on such norms effectively excludes or substitutes for the operation of the law—as with so much in commercial contract law, it is all a matter of degree. This has implications for legal reasoning since it suggests that courts must develop more sophisticated tools to examine and regulate all manner of contracting behaviour and transactional strategies. This is considered further in section 4 below.

C. Formalization in Commercial Agreements

The studies examined raise the question of why the parties might go to the trouble of planning and implementing a legally enforceable agreement even when they expect performance to be largely governed by relational norms of flexibility and cooperation. Many have addressed the economic and practical reasons for choosing one particular type of contract governance regime over another.⁶⁵ Less attention has been paid to the situation where the parties use both legal and non-legal norms, but without necessarily appointing these to govern separate stages of the relationship (as suggested by Bernstein and Collins). Evidence is available that suggests legally enforceable contracts may have significance even in broadly trusting relationships where parties do not anticipate using litigation to resolve disputes, and for reasons unrelated to the evidential advantage of having a comprehensive statement of legal obligations to hand if trouble erupts.

It is clear that contractual context is key to determining the extent to which agreements will be formalized. Increased formalization is a reflection of the expanding contracting and regulatory culture which has been observed across a wide variety of fields in the UK over the last 30 years or so (eg in relation to charities,⁶⁶ privatization of public services, outsourcing and public procurement⁶⁷). Within this context Vincent-Jones has observed that contractual documents often serve as a comprehensive 'constitution' for governing

⁶⁴ See J Ulph, 'The UCP 600: Documentary Credits in the 21st Century' [2007] JBL 355–77; M Bridge, 'Documents and Contractual Congruence in International Trade' in S Worthington (ed.), *Commercial Law and Commercial Practice* (Hart, Oxford 2003) 213.

⁶⁵ See (n 11), above.

⁶⁶ D Morris, 'Charities in the Contract Culture: Survival of the Largest' (2000) 20 LS 409–27.

⁶⁷ P Vincent-Jones, 'Contractual Governance: Institutional and Organizational Analysis' (2000) 20 OJLS 317–51.

relationships: they specify procedures for monitoring performance, reporting progress and stipulating incentives.⁶⁸ Understood in this way, the provisions of the documents may be addressed to those charged with administering, organizing and performing the project, not just to lawyers contemplating litigation or the original signatories to the written contract. Roxenhall and Ghauri have also assessed when formal contracts will be used in long-term business relationships. They identify three main reasons: (i) for transmitting information (a communication tool) both within and between firms; (ii) to reduce uncertainty and increase certainty; (iii) custom and symbolism.⁶⁹ These findings are borne out by empirical studies. In an analysis of the relationship between contracts and relational governance mechanisms, Zheng, Roehrich and Lewis examined two supply arrangements between a public buyer (National Health Service in the UK) and a private service supplier.⁷⁰ The first project involved the design, build, finance and operation of a new hospital and the second was for the construction of an emergency services training facility. The particular projects were chosen by the authors of the study because of their complexity, anticipated duration (30 years) and radical incompleteness. The complexity of the first project meant it was governed by a comprehensive set of contractual documents. Although the importance attached to formal contractual measures could be explained by the public procurement context of the project, the parties themselves regarded the documents as important to minimizing risk and achieving project outcomes. Documents addressed such issues as 'reporting and information sharing, performance measures, payment mechanisms and dispute resolution and termination procedures'.⁷¹ Although the second project was based much more on a trusting and flexible relationship, a complex contract was still drawn up. The trusting relationship was engendered between the personnel from the two sides responsible for the initial bidding and procurement phase of the project. Once this phase was over, the personnel responsible for the trust-building were moved on to other tasks. The detailed contract, while not governing the day to day aspect of the relationship, provided a much-needed source of continuing stability in the wake of inevitable staff changes. Even though several interviewees stated that they sometimes felt constrained by the formal contract, it was felt that it was only because people were aware of the contractual arrangements that flexibility in day to day

⁶⁸ Ibid 327–8. See also M Suchman, 'The Contract as Social Artifact' (2003) 37 *Law Soc Rev* 91–142, 99–100.

⁶⁹ T Roxenhall and P Ghauri, 'Use of the Written Contract in Long-Lasting Business Relationships' (2004) 33 *Industrial Marketing Manage* 261–8, 267. See also Woolthuis and others (n 43) 835. The important symbolic function of documents has often been recognized by lawyers. Lord Devlin once remarked that businesspeople 'like the solemnity of the contract, but do not care about its details': 'The Relationship Between Commercial Law and Commercial Practice' (1951) 14 *MLR* 249–66, 266.

⁷⁰ J Zheng, JK Roehrich and MA Lewis, 'The Dynamics of Contractual and Relational Governance: Evidence from Long-term Public-Private Procurement Arrangements' (2008) 14 *J Purchasing Supply Manage* 43–54.

⁷¹ Ibid 48.

performance was feasible.⁷² This study confirms that both kinds of governance mechanism—contract and trust—can be important, although in different ways, and that formal contracts can have a significant effect on the success of a project, particularly when trusting relationships cannot be sustained over time.

As well as mechanisms to regulate external exchanges, comprehensive agreements may also be tools for achieving management objectives within the firm. Staff working within a firm may not share an identity of interest and expectation with the firm over how external commercial relationships are created and managed. In his 1963 study, Macaulay observed that attitudes towards formal contracts tended to vary with staff roles within organizations. Legal and finance departments preferred a greater degree of advance planning, while sales teams regarded contract formalities as an impediment to making sales and a nuisance.⁷³ Formal contracts served as a way of disciplining sales staff who might be encouraged to make rash assurances in pursuit of a sale. The increased dependence on formalization in both internal firm processes and in the governance of external relationships is now much more widely recognized. In the context of a study of interfirm alliances, Vlaar and others, noted that ‘formalization... may... be *imposed* on participants [in an alliance] by the managers that are held responsible for the performance of the alliance’.⁷⁴ This phenomenon of legalization and formalization has been interpreted as the reflection of, and a quest for, greater legitimacy in managerial decision-making through use of formal, standardized policies and procedures.⁷⁵ But while formalization may enhance the legitimacy of managerial authority and decision-making, it gives rise to tensions and paradoxes between an adaptive personal authority and an inflexible procedural authority, and between ‘legality’ and justice.⁷⁶ Vlaar and others similarly suggest that formalization has both functions and dysfunctions. It ‘may enhance legitimacy and facilitate sensemaking’, leading to more effective coordination between partners,⁷⁷ but it also results in short-termism and reduced flexibility, motivation, innovation and creativity. While internal management mechanisms, regulatory requirements, record-keeping and agency problems are some reasons for reliance on written documents, some writers have pointed to problems with the nature of trusting relationships that might motivate parties to consider implementing formal contractual measures in business dealings. It has been argued that a close personal relationship between parties often gives rise to exactly the right

⁷² Ibid 49–50. For the lawyer’s view on the practical problems that contract documents solve see A Berg, ‘Thrashing Through the Undergrowth’ (2006) 122 LQR 354–62, 359.

⁷³ Macaulay (n 6) 66.

⁷⁴ P Vlaar, F Van Den Bosch and H Volberda, ‘Towards a Dialectic Perspective on Formalization in Interorganizational Relationships’ (2007) 28 Organization Studies 437–66, 441.

⁷⁵ SB Sitkin and RJ Bies, ‘The Legalistic Organization: Definitions, Dimensions and Dilemmas’ (1993) 4 Organization Science 345–51.

⁷⁶ Ibid 348–50.

⁷⁷ Vlaar and others (n 74) 442.

conditions for opportunistic behaviour which precipitates relationship breakdown. This is sometimes known as the 'bind and blind' effect.⁷⁸ Johnson, McMillan and Woodruff have noted that reliance on relational governance measures can lead to 'lock in' where profitable relationships with other contracting parties are not pursued.⁷⁹ This possibility might motivate parties even in a close relationship to govern a transaction by formal methods.⁸⁰ Others have argued that there are some kinds of agreement that are simply better suited to formal enforcement - complex, international trades for example.⁸¹

Given the multiple functions of written agreements, Suchman argues persuasively that contract documents are themselves worthy of study as cultural and social artefacts. For Suchman, contracts should be understood as 'scripts' which provide 'reference points for stage managing complex multiplayer productions'.⁸² They delineate the different 'roles' played by the parties and stipulate in advance the organization of 'likely scenes'. Despite identifying these various functions, Suchman would agree with Macneil that, '[e]ven meticulous performance of the most explicit planning transforms figments of the imagination, however precise, into a new, and therefore different, reality. A set of blueprints and specifications, however detailed, and a newly built house are simply not the same thing'.⁸³ While this cannot be denied, it is a charge that can be levied against anything which functions as a representation of something else. The representation will always appear flawed in comparison with the 'reality'. But even 'figments of imagination' can perform an important and genuine role, as do the blueprints and architectural drawings for a new house, despite the fact that these are not the tangible end-product of the project.⁸⁴

The scholarship examined in this section suggests that contractual documents in commercial relationships do not necessarily function only as artificial devices or formal legal safeguards. There might be various motivating factors behind the parties' attempt to place their relationship on a formal footing. Nevertheless, whatever the motives and benefits behind formalizing agreements, formalization gives rise to conflicting demands both within and between organizations. Vlaar has pointed out that polarization of positions as formalist or not-formalist obscures the complexity of what are in effect coexisting yet

⁷⁸ P Vlaar, F Van Den Bosch and H Volberda, 'On the Evolution of Trust, Distrust, and Formal Coordination and Control in Interorganizational Relationships: Toward an Integrative Framework' (2007) 32 *Group & Organization Management* 407-29, 416-7.

⁷⁹ Johnson, McMillan and Woodruff (n 59) 259.

⁸⁰ E Anderson and SD Jap, 'The Dark Side of Close Relationships' (2005) 46 *MIT Sloan Manage Rev* 75-82.

⁸¹ Trebilcock and Leng (n 17) 1575.

⁸² Suchman (n 68) 115.

⁸³ Macneil (n 3) 663.

⁸⁴ Suchman remarks, 'At best contracts serve as blueprints and programs, not as actual governance mechanisms': (n 68) 107.

contradictory pressures. Managers and contractors have to make a variety of trade-offs and it is too simple to reduce these to choices between only two variables of 'flexibility' and 'control', or between 'competition' and 'cooperation'.⁸⁵ Formal contract measures will often operate in addition to reliance on relational norms, not as a substitute for them. Given this, in many cases it is simply not possible to reach a determinate conclusion that *either* relational *or* formal norms underpinned an agreement. Neither can it be assumed that a close examination of the relationship will yield information concerning the correct set of norms that should be used for resolving the dispute. In the final substantive section of the article, I consider how contract law can respond to the ambiguity that many commercial relationships display in their governance framework.

4. *Contract Law and Legal Reasoning*

A. *Relational Legal Reasoning*

While sociolegal scholars differ over the precise implications of relational theory for contract law and legal reasoning, most generally agree that a contextual approach to contracts regulation should be taken, at the expense of an inflexible doctrinal method. Feinman, for example, states that relational analysis is 'contextual with a vengeance',⁸⁶ requiring a pragmatic, differentiating approach depending on contract type. We may have to accept that dispute resolution according to this scheme will look less like traditional contracts legal reasoning and more like a results based 'policy analysis' which proceeds from a starting point of obligation between the parties, rather than no obligation, and a spirit of cooperation rather than competition.⁸⁷ Feinman is probably right that the correct approach must be a contextual one, but probably wrong to think switching the default position of the classical law provides a solution. The work examined above suggests that we abandon the idea that contract law can comprehend contractual relationships by assuming they are either competitive or cooperative. Unfortunately, litigation often proceeds on the basis of this understanding. Lawyers representing the parties will usually articulate opposing interpretations of what the agreement requires based upon either the formal contract scheme (or lack thereof) or more flexible understandings. Legal reasoning in contract cases thus tends to reinforce the idea that business dealings can be classified in binary terms of 'formal' or 'not-formal'. While readily understood (and perhaps encouraged by the adversarial nature of litigation) this classification is an unhelpful way of thinking about the commercial

⁸⁵ Vlaar and others (n 74) 440.

⁸⁶ J Feinman, 'Relational Contract Theory in Context' (2000) 94 Nw U L Rev 737–48, 742.

⁸⁷ Ibid 740–3.

relationship, since the distinctions upon which it turns are not easily made and most likely do not reflect that the agreement is both relational and formal at the same time. Of course it could be argued that the parties' recourse to litigation is itself indicative of a commitment to formalization and strict legal enforceability (leaving aside the question of what 'legal' means for these purposes). But such a fixed attitude sits uneasily with judicial rhetoric concerning the 'reasonable expectations' of business people and the role of law in 'oil[ing] the wheels of commerce'.⁸⁸

An example of the ambiguity over governance structures that commercial contracts often display is provided by *Emcor Drake and Scull Ltd v Sir Robert McAlpine Ltd*.⁸⁹ While we must recognize that litigation provides a new context which affects the way the agreement is presented and understood, the case illustrates how both relational and formal legal norms can intertwine in a commercial relationship. This feature poses a considerable challenge for any attempt to map the parties' behaviour against two mutually exclusive variables of 'formal' and 'not-formal'. The case concerned a private finance initiative (PFI) for the construction of new buildings and the refurbishment of an NHS hospital in the West Midlands. Sir Robert McAlpine (SRM) was the main contractor on the project and Emcor, Drake and Scull (EDS) had successfully tendered for the mechanical and engineering works. SRM and EDS were in discussion for a year before a price of £34.25 million for the works was agreed in principle between them. About 18 months after EDS commenced work on the site there was evidently an acrimonious breakdown in the parties' relationship, precipitated (according to the judgments) by EDS refusing to undertake any further work without a formal subcontract. SRM claimed this was a repudiatory breach, arguing that an initial letter agreement and series of order contracts constituted a binding commitment to complete the entire installation for about £35 million.⁹⁰ EDS argued that their commitment only extended to carrying out work commissioned under the series of order contracts (each valued up to £1 million) and that they had no ongoing obligation to complete the entire project. While the parties had anticipated a formal subcontract, this had never been executed due to a failure to agree terms. Predictably, both the trial judge and the Court of Appeal concluded that, without a formal subcontract, EDS were not obliged to complete the work and there had been no repudiatory breach.

It seems clear from the case report that throughout their relationship the parties demonstrated a simultaneous commitment to both contract formalities and non-legal norms in governing their agreement. Indicators of discreteness

⁸⁸ See respectively Lord Steyn, 'Contract Law: Fulfilling the Reasonable Expectations of Honest Men' (1997) 113 LQR 433–42 and Lord Goff, 'Commercial Contracts and the Commercial Court' [1984] LMCLQ 382–93, 391.

⁸⁹ [2004] EWCA Civ 1733.

⁹⁰ The case is thus a good illustration of the phenomenon of the umbrella agreement: see S Mouzas and M Furmston, 'From Contract to Umbrella Agreement' (2008) 67 CLJ 37–50.

were that EDS were not prepared to start any work without some, albeit short term, formal contractual protections in place, particularly covering payment. In addition, the complexity, value and risks of the project suggested the need for 'clear unequivocal agreement from the outset between the parties as to their respective obligations to avoid later difficulties'.⁹¹ The understandings, practices and contracting culture prevalent in the construction industry also pointed towards a preference for discreteness.⁹² But there were also significant indicators of relational underpinnings to the agreement: the parties had worked together before, and SRM had indicated to EDS before the tendering process that they were the preferred bidder for the works; although SRM attached importance to getting 'unequivocal agreement from the outset', EDS worked on the project and SRM paid them for 18 months, despite a formal subcontract for the entire works not being in place; the convoluted arrangements surrounding the letter agreement (issuing letter agreements was contrary to SRM internal policy, but SRM circumvented their own formal procedures by producing a letter agreement which had the appearance of originating from EDS, in order to ensure EDS started work).

It appears from the judgments that it never occurred to either party that they might fail to reach agreement on a formal subcontract. Nor did the parties ever seem to consider that EDS were not employed to complete the entire project (at least before the dispute arose). Of course, this might be interpreted as showing either that the subcontract was not that important to them (and only became so when the relationship was in trouble) or that they fully expected to reach agreement on its terms at some stage. The former interpretation seems unlikely however. The parties evidently felt that they could not rely solely on trust or informal understandings to regulate such a complex and risky project, and undoubtedly the controversial PFI background also influenced choice of governance. However, it appears from the report that it was precisely difficulties over the formalities that precipitated the dispute, although undoubtedly there were other pressing problems that played a role, notably the escalating costs of the project. Relational scholars might regard this as a good illustration of how haggling over formal contract terms can undermine trust and lead to relationship breakdown. On the other hand it could be argued that getting the formalities right might well have given some much needed strength and stability to an otherwise fragile relationship. The difficulty is choosing between these two interpretations of the parties' behaviour, both of which may have an element of truth. This seems to demonstrate the simultaneous importance (getting it right, and the several attempts made to get it right) and

⁹¹ This statement came from one of the witnesses for SRM: [2004] EWHC 1017 [8].

⁹² The 1998 Egan Report on the UK construction industry criticized the 'contract culture' operating in the industry, arguing that excessive reliance on formal contracts contributed to fragmentation and inefficiency in the sector, and prevented contractors developing a sense of overall responsibility for the success of the project: *Rethinking Construction: The Report of the Construction Task Force* (HMSO, London 1998).

lack of importance (starting the work without the comprehensive planning documents in place) that parties attach to the formal contractual scheme.

Even when formal contract measures are completely lacking in a relationship the implications to be drawn from this may not be obvious. The case of *Baird Textile Holdings Ltd v Marks & Spencer plc*,⁹³ affords an example. The decision in the case might be criticized on the basis that the Court of Appeal paid insufficient attention to the parties' tacit understandings about the continuity of the business relationship. These tacit understandings constituted an informal 'umbrella agreement' that governed the series of discrete contracts and created an obligation not to terminate the relationship without warning.⁹⁴ Whether the Court of Appeal did get the decision wrong arguably depends upon why the parties failed to formalize their business relationship. On the one hand, this could be because the parties felt that strict contract formalities were unnecessary in the light of the trusting and cooperative alliance they had built up over 30 years. In this situation, it may be open to a court to determine that Marks & Spencer were obliged to give notice before terminating the relationship, on the basis of the (non-contractual) reasonable expectations of the parties. On the other hand, the lack of any formal contract governing the long-term relationship could be interpreted as an awareness of the 'lock-in' problem and a deliberate strategy to preserve the right to an obligation-free exit by either party if they felt their business interests lay elsewhere. If this was the parties' understanding then the Court of Appeal reached broadly the right decision. However, it is difficult to say that one of these alternatives is *demonstrably* correct, since both interpretations will probably elicit agreement at one time or another (or even at the same time) depending on who is questioned and when they are asked.

Given that courts face these myriad difficulties, but are still required to reach a decision, how should legal reasoning about contracts proceed? One conclusion is that the implications are all for contract design, rather than contract law. Some scholars prefer that it is left to the parties, as private law-makers, to either write terms reflecting cooperative or flexible commitments into their contracts,⁹⁵ to choose more clearly between formal and substantive interpretative regimes (or regimes that can be predicted as likely to adopt a more formal or less formal approach),⁹⁶ or to opt-in to dispute resolution procedures that are more suited to mediating between contradictory aspects of their relationship. Insofar as courts have a role, Macaulay has suggested that their function is to encourage the parties to settle rather than take their dispute

⁹³ [2001] EWCA Civ 274.

⁹⁴ Mouzas and Furmston (n 90).

⁹⁵ E McKendrick, 'The Regulation of Long-Term Contracts in English Law' in J Beatson and D Friedmann (eds) *Good Faith and Fault in Contract Law* (OUP, Oxford 1995) 305, 332.

⁹⁶ Katz (n 11) 500.

through to trial and judgment.⁹⁷ None of these approaches, however, address whether legal reasoning about contracts can reconcile the coexisting but conflicting normative structures displayed within contractual relationships or comprehend that the parties' agreement may reflect a *genuine* struggle to assimilate both formal legal and relational norms.⁹⁸ What is required is a method of conceptualizing formal and relational mechanisms as integrated phenomena, rather than poles existing at either end of a linear scale. Somewhat counterintuitively, this seems to suggest a more pragmatic, fragmented contract law. Judges and scholars may have to accept that outcomes will be sensitive to the parties' individual case and are likely, therefore, to be radically indeterminate. In the remainder of the article, I consider some aspects of contract law which display a degree of sensitivity to the combined formal and relational aspects of commercial agreements and which may thus provide tools for mediating between these elements.

(i) *Informal agreements*

The intersection of formal and relational norms in contract cases appears most clearly where the parties act as though they have created formal obligations towards each other, but the 'legality' of their obligations is doubtful. In relation to this, Mouzas and Furmston have convincingly argued that the law should recognize that parties often construct and rely upon informal devices to signal commitment, such as letter agreements and letters of intent.⁹⁹ These instruments currently occupy a legal 'grey area', but are often indicative of the parties' attempt to garner the benefits of legal enforceability and their aspirations to achieve some concrete outcome from their agreement. Given this, it is arguable that in some circumstances such agreements should be enforceable at law, despite their informality. In *Emcor*, for example, a formal subcontract was contemplated, but never executed (this contrasts with the *Baird* case). The parties did make use of a letter agreement and a series of order contracts however, which governed their relationship for several months. Taken together, the umbrella agreement and relational norms suggested that EDS had an obligation to complete the whole works, and this is entirely consistent with the way the parties behaved towards one another during the currency of their relationship. If a court accepts that such obligations can be legally binding then it has created an intermediate legal position lying somewhere between a legally-watertight documented agreement and flexible norms of cooperation. This path, forged between the competitive and cooperative aspects of the parties'

⁹⁷ Macaulay (n 2) 67–8.

⁹⁸ The unstated assumption here is that contract law *should* attempt to comprehend and reconcile these elements. To be clear, I am leaving aside consideration of this important issue, while recognizing that it is controversial: see Gava (n 34).

⁹⁹ Mouzas and Furmston (n 90). See also Lyons and Mehta (n 35) 51.

relationship, seems preferable to treating the formal subcontract, or lack of it, as enjoying pre-emptive status as the exclusive source of legal obligations.

Of course, determining that the 'grey area' can give rise to legally enforceable obligations does not necessarily determine what those obligations are. While courts show a willingness to make commercial contracts work, and to imply terms on grounds of business efficacy, necessity and policy, they profess reluctance to 'create' contracts for the parties. This may not cause too much difficulty in cases where the 'grey area' is sufficiently detailed, but if too much is left to be implied an agreement may fail for uncertainty. This is not a conclusion that courts should readily reach, particularly when the parties have acted upon the agreement. Courts should not overestimate the importance the parties place on certainty in their agreements. Perhaps more importantly, vagueness and equivocation between formal and relational norms is exactly what courts should expect in commercial agreements. This is considered further in the next section.

(ii) *Reining in 'uncertainty'*

The distinction the law makes between contracts that can be rescued from uncertainty by implication of terms or interpretation and those that cannot is a fine one. This often causes difficulty, since the degree of certainty required by the parties to make the contract workable on a day to day basis may be somewhat less exact than the standard required by law. *Durham Tees Valley Airport Ltd v BMI Baby Ltd*¹⁰⁰ is a recent and interesting example. The owners of DTVA entered into a 10-year contract with BMI Baby (the budget-airline subsidiary of British Midland Ltd) under which the airline agreed to base two aircraft at the airport by a certain date. The deadline for achieving this was later extended by a novation and variation agreement. In return, DTVA offered various financial incentives to BMI Baby and also undertook a £10 million redevelopment of the airport. Passenger numbers were disappointing however, and BMI Baby were not able to make a profit from the operation. Following a change in senior management, the airline withdrew from DTVA with 8 years of the agreement left to run. DTVA claimed damages for breach of the agreement. The airline maintained that while the agreement permitted it to base aircraft at DTVA, it imposed no legal obligation to do so.

Davis J accepted that it was open to BMI Baby to withdraw from DTVA for commercial reasons, but pointed out that this did not necessarily entail the airline was contractually free to do so.¹⁰¹ He did not regard it as 'unthinkable', as BMI Baby claimed, for an airline to lock itself into a long-term contract within an industry notorious for its sensitivity to the fluctuating economic climate. He concluded that there was a contractual obligation on BMI Baby

¹⁰⁰ [2009] EWHC 852 (Ch).

¹⁰¹ *Ibid* [58].

to 'establish...and thereafter to continue to base and to operate two aircraft: and this obligation was for the term of the contract'.¹⁰² Nevertheless, while the judge decided BMI Baby had a contractual obligation, he was unable to determine precisely what it was they were obliged to do. Questions as to how many flights BMI Baby were expected to operate and the number of passengers they were obliged to carry did not have any objectively ascertainable answers. The end result was that the 'contract' failed for uncertainty since the judge held that there was no basis upon which workable terms could be implied.

Leaving aside the question of whether contractual obligations can exist in the abstract (can one be under a *contractual* obligation that has no substantive content?) it seems clear that what weighed with the judge in the case was his inability to formulate specific terms that could yield a quantifiable damages award for breach. Within the backward-looking context of litigation, this concern is understandable, but to regard it as determinative of the issue of liability is to ascribe an entirely different purpose to the written agreement than that envisaged by the parties. The contract (and variation) between DTVA and BMI Baby was an attempt to record obligations with some degree of precision to produce a mutually beneficial outcome in what was by all accounts a very risky undertaking. Evidence from aviation industry experts suggested that industry conditions militated against specifying formal obligations as to flying programmes with any degree of certainty or any expectation of permanence.¹⁰³ It is highly unlikely that the contract was ever intended to be a complete statement of legal obligations relevant only in the situation of relationship breakdown (the agreement was not drafted by lawyers, but by the parties themselves, although it was reviewed by an in-house legal department¹⁰⁴). In this respect the 'paper deal' fully reflected the 'real deal'. But in taking the agreement out of the context in which it was formed, the judge here sets a standard for certainty that is almost impossible for the parties to reach. The effect of this is twofold: firstly, it takes contractual arrangements in some industries outside the realm of legal regulation altogether; secondly, the law's resolute message is if commercial parties evince an intention to go down the formal route, little allowance will be given for error or vagueness. As it is, the use of the stark formal/non-formal distinction allows the agreement to fall through a legal safety net. Implied terms to govern such situations are possible, as Davis J's own review of the authorities revealed. The judge distinguished most of these cases 'on the facts' without appreciating that most commercial cases will be so distinguishable.¹⁰⁵ In the light of his conclusion that a contractual obligation existed between the parties, Davis J's reluctance to go any

¹⁰² Ibid [82].

¹⁰³ Ibid [99].

¹⁰⁴ Ibid [24].

¹⁰⁵ Ibid [103]–[106].

further with spelling out the obligations and awarding damages for breach appears perverse.

One strategy then for dealing with commercial contracts that display elements of both formalism and relationalism is to rein in uncertainty and confer legal status on the agreement, if necessary by using techniques of implied terms, collateral contracts and so on. Another possibility is for parties to provide for ongoing variation within the terms of their agreement and for courts to interpret such terms flexibly.¹⁰⁶ A judge may be able to take an expansive approach to doctrines such as consideration¹⁰⁷ and estoppel (in all its various forms) in order to render an agreement effective for achieving its purpose. More specifically, estoppel by convention can be a useful technique for giving effect to understandings that were clearly shared by both parties, and which formed the basis for the agreement, but which appear to be contradicted by the written form.¹⁰⁸ More broadly, the contextual interpretation of contracts can provide an important mechanism for integrating the formal and relational aspects of a commercial agreement. This is considered further below.

(iii) *Contextual interpretation*

Suchman is probably correct when he identifies that a fully interpretative approach is necessary to understanding formal contracts and their role in commercial relationships.¹⁰⁹ In developing his contextual interpretative approach in *Investors Compensation Scheme v West Bromwich Building Society*,¹¹⁰ and subsequent judgments, Lord Hoffmann has displayed some sensitivity to the idea that contracts are both social and legal phenomena. In *The Starsin*, for example, he chose to interpret obligations according to how the contract users (which were not confined to the parties and their lawyers) would interpret them. He reckoned, probably accurately, that such users would generally only investigate the front of the document rather than engage in minute analysis of the small print on the reverse (which was regarded as the lawyer's task).¹¹¹ In the recent Privy Council decision in *Attorney General of Belize v Belize Telecom Ltd* Lord Hoffmann similarly described contractual implication as a search for 'the meaning which the instrument would convey to a reasonable person having all the background knowledge which would reasonably be available to *the audience*

¹⁰⁶ McKendrick considers some of the specific clauses that may be inserted into contracts to facilitate adjustment: (n 95) 321–32.

¹⁰⁷ The most important modern example of such an approach being *Williams v Roffey Bros and Nicholls (Contractors) Ltd* [1991] 1 QB 1.

¹⁰⁸ *Amalgamated Investment & Property Co Ltd v Texas Commerce International Bank Ltd* [1982] QB 84.

¹⁰⁹ Suchman (n 68) 100.

¹¹⁰ [1998] 1 All ER 98.

¹¹¹ *Homburg Houtimport BV v Agrosin Private Ltd (The Starsin)* [2003] UKHL 12; [2004] 1 AC 715, [75]–[82]. This approach is supported by empirical evidence. In investigating the attitude of respondents to the paperwork, Lyons and Mehta wrote that 'the back of this form has standard conditions "which don't mean a thing" [footnote omitted], but the front is important: anything that matters is put there... Both parties agree that the back of these forms (even their own) is meaningless': (n 35) 58.

to whom the instrument is addressed'.¹¹² Lord Hoffmann here shows some appreciation of the multiple purposes documents serve and that their relevance may reach well beyond the original parties to the agreement.

Of course, contract scholars are familiar with the move to contextual interpretation in contracts, although there is continuing debate about how radical this process is, how far it promotes contract revision and whether it eclipses the operation of other contract doctrines (such as rectification and implication of terms, for example). If the empirical findings detailed above are relevant to contract law (as I would suggest they are) then contextual interpretation may be an important technique for understanding contracts, provided it is grasped that the subject-matter for interpretation is the entire commercial relationship, of which the text may be an important, but not exclusive, part. A fully contextual approach must examine more closely the precise role of the documents in the relationship.¹¹³ This is suggestive of certain lines of enquiry when attempting to resolve contractual disputes, especially those that pit formal documents against flexible, non-contractual understandings. Chiefly, courts should recognize that the documents may serve a variety of purposes depending on contractual context and the quality of the parties' relationship. In non-trusting relationships the formal contract may be a protective and security measure, specifying monitoring and enforcement procedures that safeguard the parties from opportunism. In trusting relationships the contract may be used for more benign purposes of project coordination, record-keeping and reassurance.¹¹⁴ It also seems likely that the documents perform a more perfunctory role in short-term, one-shot deals (eg a basic record of specification, quantity, price, delivery arrangements, etc) than in agreements expected to endure over a longer period. Industry context may provide important information to a court about the standard of precision that can be expected in a written contract (as in the *DTVA* case, for example) and about the participants' attitudes towards legal enforcement. Similarly, the law should take account of industry understandings about why specific terms are included in formal documents. In *Total Gas Marketing v Arco British*,¹¹⁵ for example, a seemingly important, but overlooked, point of context was that the contract condition upon which the gas buyer, Total, were able to rely in escaping from the agreement was one usually inserted into the agreement for the protection of the gas seller, Arco. Understood in this way, what the process of contextual interpretation requires is not the construction of the parties' agreement, but the *reconstruction* of it—the reassembly of its constituent parts and the expectations and motivations, both documented and undocumented, that helped create it.

¹¹² [2009] UKPC 11 [16] emphasis added.

¹¹³ H Collins, 'Objectivity and Committed Contextualism in Interpretation' in S Worthington (ed.) *Commercial Law and Commercial Practice* (n 64) 189, 191–3.

¹¹⁴ Woolthuis and others (n 43) 834–5.

¹¹⁵ [1998] 2 Lloyd's Rep 209 (Lord Hope).

Understood as a technique which is not confined to decoding words and phrases in formal contractual texts, contextual interpretation has implications for contract law rules and doctrines. Lord Hoffmann's judgment in *The Achilles* illustrates this wider effect of interpretation.¹¹⁶ The issue in this case concerned the extent of a charterer's liability following the late return of a ship to the owners, with the consequence that the owner was obliged to renegotiate the hire on the following fixture and accept a lower rate. Was the charterer liable for the loss of profit on the entire following fixture, or just for the period of the delay? One possibility is that the case should be determined by applying an external legal standard, that is to say, the remoteness rule in *Hadley v Baxendale*.¹¹⁷ On this basis it might readily be concluded that the loss of profit on the entire following fixture should be recoverable, since this was a natural consequence of the breach (applying the first limb of the *Hadley v Baxendale* test). Lord Hoffmann preferred the view that the extent of the charterer's liability was not a matter of the application of external legal standards, but a question of contract interpretation (broadly understood), specifically whether the charterers had assumed responsibility for the risk of a loss which was unquantifiable when the contract was made.¹¹⁸ This interpretative approach was necessary in order to take account of the industry understanding that the charterer's liability was restricted to the difference between the market rate and the charter rate for the period of delay. For Lord Hoffmann the starting point for assessing liability is not *Hadley v Baxendale*, but the agreement between the parties, which includes the tacit understandings prevalent within the industry (including shipping lawyers). Such practices provide an important marker against which the 'fit' of various competing interpretations offered by the parties can be judged. One can take Lord Hoffmann's judgment in *The Achilles* as a far reaching, but inevitable, consequence of his contextual interpretative approach to contractual relationships. It also demonstrates the possibility of unifying the law and the parties' understandings into an integrated scheme that attempts to do some justice to both the law's role as background regulator of economic exchange and the complexity of agreements and relationships that contracting parties create.

5. Conclusion

The conclusion to be drawn is that the implications of the sociolegal findings for contract law are perhaps not so obvious as counsel's argument in *Balmoral*, which opened this article, seems to infer. The quoted passage suggests that the

¹¹⁶ *Transfield Shipping Inc v Mercator Shipping Inc* [2008] UKHL 48; [2008] 4 All ER 159.

¹¹⁷ (1854) 9 Exch 341.

¹¹⁸ *Transfield* (n 116) [11]. Lord Hope was largely in agreement, but Lord Rodger and Baroness Hale preferred the narrower ground that preserved the operation of *Hadley v Baxendale*: since the loss on the following fixture was the result of an extremely volatile market it was not within the charterer's contemplation and was not recoverable. Lord Walker agreed with elements of both approaches.

courts are involved in a search for the *genuine* contract, which will *either* be found in the documents *or* the implicit dimensions of the agreement. This argument owes much to the sociolegal critique of classical contract law, which has undoubtedly been successful in raising awareness of the social embeddedness of economic transactions. One of the refrains within this scholarship is that formal contracts and contract law offer only narrow, artificial perspectives on complex phenomena, and that legal reasoning might be improved if the law sought to incorporate into the agreement the informal norms, practices and understandings generated from within the parties' relationship. This line of argument is often addressed to judges who resolve commercial disputes, since they have the most influence over contract law development. It is also directed to legal academics as part of an appeal to abandon the narrow conception of contracts and contracting parties assumed by the classical law in favour of alternatives which are cognizant of the social foundation of all transactions. But this argument is itself an oversimplification. After examination of the difficult relationship between contract and trust, and the formalization of processes of commercial exchange, it becomes apparent that there are a diverse range of contract governance schemes available to the parties, and an even more diverse range of factors that will determine their choice of governance. What does seem clear is that formal contracts, contract law and legal institutions cannot be completely written off as only a minor part of commercial transactions.

In the light of the findings of empirical studies that have examined how parties decide on contract governance regimes, it would seem closer to the truth to assert that in many cases contractual relationships are governed both by documents and relational norms *at the same time*. This suggests that contracts legal reasoning should not be concerned with distinguishing what is 'artificial' and what is 'authentic' in the contractual relationship, at least insofar as this investigation proceeds on the basis that legally enforceable contracts and relational norms are mutually exclusive governance regimes. The technique of pitting the 'real' against the 'artificial' is, of course, encouraged by the adversarial nature of court based litigation procedures and many legal disputes hinge (or are made to hinge) on a discrepancy between what the documents say and what one of the parties believes is the 'true' position. But the implication that it is possible to generalize about all contractual relationships in binary terms is itself artificial and unhelpful. To the extent that what courts do is relevant to contracting parties, courts need to develop a fully interpretative, contextual and integrated approach to economic transactions. Or at least they must do so if they are to demonstrate awareness of the social embeddedness of contractual obligations, revealed in all its diverse aspects by empirical studies of contract behaviour.