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Default Rules in Contract Law as Response to Status Competition in Negotiation

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Stephen M. McJohn +

I. Introduction

Contract law facilitates exchange by reducing the costs of exchange. The lower the costs of entering into, performing, and enforcing contracts, the easier it is for parties to benefit from trade gains. This Article explores whether a broader view of the "costs" of contracting will disclose additional functions of contract rules. Many contract rules serve as default rules, rules that fill in gaps parties do not specifically address.¹ For example, Article 2 of the Uniform Commercial Code consists primarily of default rules for contracts for the sale of goods. If the contract between buyer and seller does not specifically address matters such as the amount of damages in case of breach,² the rights of the parties with lost goods,³ warranties of goods are warranted,⁴ the terms of delivery,⁵ or even the price,⁶ then contract law will provide these terms. If the parties do not wish to rely on such default rules, they can provide their own terms.⁷

Default rules reduce the costs of contracting in two principal ways. First, default rules reduce transaction costs.⁸ The parties can rely on contract law to supply terms, thus, diminishing the costs of negotiating, drafting, and executing a contract. Reducing transaction costs is key to facilitating exchange because parties can only benefit from a transaction if the gain from trade exceeds the transaction costs. Second, some default rules may reduce costs of strategic behavior.⁹ If one party in contract negotiation has material information unavailable to the other party, the informed party may have an incentive to engage in strategic behavior. By not disclosing the information, the informed party may negotiate more favorable terms than it would in the event of disclosure. Although such strategic behavior may benefit the informed party, the reduction in trade gains may outweigh it. For example, the nondisclosed information could involve a risk that the un-informed party could have efficiently guarded against. Default rules may reduce such strategic behavior by providing an incentive to reveal private information that can increase gains from trade.

This Article also discusses another role for default rules--reducing costs of status competition. Default rules principally serve to reduce transaction costs and strategic behavior costs, but they also accomplish other functions.¹⁰ The hypothetical behavior of parties that measure the costs and benefits of the transaction in absolute terms provide a basis transaction and strategic behavior cost analysis. Parties in actual negotiations, however, often shift to measuring things in relative terms because of concerns about status. The participants enter into contract negotiations to achieve gains from trade. The process of negotiation itself, however, may become a competition. Rather than simply trying to achieve their original goals, parties sometimes shift in whole or in part to "win" the bargaining. Such status competition may have two types of costs. It may increase the resources expended in bargaining by making the

negotiations longer or more complex, and it may reduce gains from trade by causing negotiations to fall through.¹¹ The shift can harm the parties as a whole by changing the negotiation from one with potential gains from trade for both parties to one where any gain for one party results in a perceived loss to the other party. This Article also addresses how default rules of contract law may operate to reduce such costs of status competition during negotiation.¹²

II. How some default rules reduce transaction costs by supplying terms that parties would have agreed on

The transaction cost analysis of default rules is a straightforward application of the Coase theorem, the analytical tool that underlies much economic analysis of law.¹³ The Coase theorem states that if transaction costs between parties are zero, the parties by agreement will allocate property rights efficiently.¹⁴ In other words, rational parties will make trades if the parties can make economic gains and transaction costs do not stand in the way.¹⁵ Suppose a farmer has a plot of land worth \$ 1000 a year to the farmer and use of that land would be worth \$ 1200 a year to a neighboring farmer. Without transaction costs, for example costs of negotiating, executing, or enforcing a lease, the parties could realize a \$ 200 gain from trade if the second farmer could agree to lease the land for more than \$ 1000, and less than \$ 1200. If transaction costs were \$ 300, however, the mutually beneficial transaction would not occur, because the cost would outweigh the benefit to the parties. Therefore, the law can facilitate exchange by reducing transaction costs.

Contract law reduces transaction costs by providing a background of default rules that make it unnecessary for contracting parties to expend resources in bargaining about every possible aspect of a contract.¹⁶ High transaction costs may not completely block bargaining, but the existence of any transaction costs at all will reduce the overall amount of exchange. In addition, if the parties had to address every possible contingency to form a binding contract, the transaction costs of negotiating and drafting would rise prohibitively high.¹⁷ Because contract law provides default rules, the parties need not expend transaction costs in reaching specific agreement about every single aspect of the transaction.

Similar reasoning can also apply to determine appropriate default rules. If the parties could bargain costlessly, then they could reach an efficient agreement about every aspect of the contract.¹⁸ In deciding what default rules are appropriate, a legislature or court may determine what terms the parties would agree on. Thus, the transaction cost analysis yields an approach that courts have in fact long applied, possibly termed the "wouldhave" approach--¹⁹ the default rule to fill a gap in a contract should be the provision that the parties would have included, had they considered it.²⁰

III. How some default rules reduce costs of strategic behavior by forcing disclosure of material information

Considering costs of strategic behavior suggests that some default rules serve not simply to fill in gaps with what the parties would have agreed on, but rather serve to induce parties to address some matters, specifically, to reveal material information. Game theory analysis²¹ suggests that transaction costs are not the only barrier to realizing gains to trade. Even where transaction

costs are low, parties may fail to maximize gains from trade because their conflicting interests may induce strategic behavior.²² Where parties have asymmetric information, one party knows something the other does not, the "would-have" approach discussed above may encourage inefficient strategic choices. In particular, if the default rule governing one area of the contract favors one party, then that party may choose not to address the matter during contract negotiations to prevent disclosing material information.

A leading analysis demonstrates the costs of strategic behavior rigorous with respect to default provisions on consequential damages.²³ Both parties may not have incentives to seek the agreement with the greatest overall benefit. The "would-have" approach assumes that the parties will maximize the gains from trade--maximize the size of the pie to be divided between them.²⁴ One party with private information, however, might have an incentive to bargain for a larger share of a smaller gain from trade--a larger slice of a smaller pie.²⁵ Default rules that differ from the "wouldhave" approach may discourage such behavior. A scenario drawn from *Hadley v. Baxendale*²⁶ illustrates the interplay using a contract between a shipper and a carrier.²⁷ The shipper is a miller that wants to have a broken crank shaft transported to a repair shop in another city. If the carrier does not deliver the crank shaft at the agreed time, the mill will shut down for a time, resulting in lost revenue for the miller. The carrier is in the best position to take efficient precautions against the risk of the shaft's late delivery. If the shipping contract does not address the issue of consequential damages, the question is whether the default rule should grant consequential damages to the shipper in the event of breach by the carrier.

As discussed above, the transaction cost approach would find the term that the parties would have agreed on, had they addressed the issue. If the carrier was in the best position to reduce the risk of the crank shaft going astray by taking extra precautions, then the parties likely would have placed the risk of consequential damages on the carrier.²⁸ Such a rule, however, could lead to inefficiencies. The carrier might deal with many shippers, only a few of whom would suffer considerable consequential damages from late shipments. Courts deem these shippers as "high-damage" shippers. A default rule making carriers in the best position to avoid losses liable for consequential damages would place possible consequential damages on the carrier with respect to every shipper. Carriers may also prefer to charge more for high-damage shippers than for low-damage shippers to pay for the extra precautions. To do that, however, carriers need to identify both high-damage and low-damage shippers. High-damage shippers would have an incentive not to disclose their status and simply rely on the default rule.²⁹ The carrier may distinguish between high-damage and low-damage shippers and deal with them accordingly.³⁰ If there are only a few high-damage shippers, however, it might be less costly for the carrier to occasionally pay consequential damages than to classify every shipper as a low-damage or high-damage shipper.³¹ Accordingly, the carrier under the "would-have" rule would not take efficient precautions.³²

An approach different from the "would-have" approach could prevent such an inefficiency. If the default rule awards consequential damages, high-damage shippers have a strategic incentive to pass as low-damage shippers.³³ If they inform the carrier that they are high-damage shippers, the carrier will take the efficient precautions to avoid loss, but will also charge a higher price for the shipment to reflect those precautions and possible damages. If the default rule

grants consequential damages, the shipper is insured against loss, and can avoid the higher price by failing to disclose.³⁴ The Hadley rule, however, fosters efficient behavior precisely by differing from the rule that the parties would have reached, through bargaining. Hadley denies consequential damages unless the carrier could foresee the loss. For protection of consequential damages, the miller must therefore disclose its status as a potential high-damage shipper. Then, the parties will adopt the term that the "would-have" rule dictates providing for consequential damages. But the carrier will know which shipments require precautions, and will charge high-damage shippers extra in exchange for taking those efficient precautions.³⁵ Rather than simply mimicking the agreement the parties would have reached, some default rules force efficient disclosure of information by differing from the term the parties would have chosen.³⁶

By simply filling in gaps with terms the parties would have chosen, the transaction cost approach views contract default rules as a method of lessening the cost for parties to reach an efficient bargain. Strategic behavior costs further explain how default rules may induce parties to disclose information, to reach the efficient bargain.³⁷ The next section turns to a different type of cost—costs of status competition.

IV. Status competition costs defined

The transaction cost and strategic behavior cost analyses review the costs and benefits in terms of the parties' transaction costs and the parties' receipts in the exchange. In so doing, the analyses assume away considerations of status, although status is often an important factor in actual negotiations. Like economics generally, economic analysis of law has paid scant attention to the fact that people frequently seek goods and services not only as ends in themselves, but also as means of establishing position with others.³⁸ As economists sometimes note³⁹ social sciences like psychology, sociology and anthropology have found repeatedly, the desire to compare well against others influences parties' decisions.⁴⁰ Of course, it is not an esoteric observation of social science that people often prefer to earn more than others or have things that few people have. The marketing of goods and services confirms this everyday. Most advertising appeals directly to the widespread desire to own things that purportedly signal superior taste, wealth, or judgment, and to receive services that will raise people on various scales of comparison.⁴¹ Such "relative preferences" are not something foreign to economic analysis of law but rather constitute a few of the many items generally excluded from the analysis.⁴² A full understanding of how contract law affects negotiations, however, cannot disregard this factor that often controls the negotiation.⁴³

The costs of status competition flow from a particular type of desire for status, the desire to be the "winner" of a negotiation. This desire may have a detrimental effect on negotiations by shifting a party's goal from obtaining a beneficial trade to winning a negotiation point. Although economic analysis of law affecting bargaining may assume away the complications of status competition, lawyers and others writing about the actual process of negotiation regularly address the matter. In the words of a book often used in teaching negotiation in law school, if such a shift occurs, "Your ego becomes identified with your position. You now have a new interest in 'saving face' . . . making it less and less likely that any agreement will wisely reconcile the parties' original

interests."⁴⁴ Others have termed it as motivational transformation. It begins as an interest in doing as well as one can, and shifts to an interest in prevailing over the other side.⁴⁵ Negotiations can go awry where such issues of status interfere with parties seeking their original goals.⁴⁶ Indeed, parties may become unable to agree to a transaction that gives them what they actually want, simply because such agreement would cause loss of status.⁴⁷ Negotiation texts devote much space to techniques for alleviating such impasses--to permit parties to escape the status competition without "losing face."⁴⁸ If widespread status competition requires negotiators to develop techniques to deal with it, then the law that affects negotiations should also have mechanisms to reduce such costs.

The breakdown of negotiations for the sale of a house provides a clear example of status competition costs. Suppose Seller has a house that she would gladly sell for \$ 100,000, and Buyer would gladly purchase for \$ 110,000, with transaction costs of \$ 1,000. Thus, the parties have a potential gain from trade of \$ 10,000, minus \$ 1,000 transaction costs. The transaction cost approach would assume that they would make an efficient agreement. Consideration of strategic behavior costs would likewise predict that the parties would bargain to an agreement.⁴⁹ Game theory may predict a likely price if the parties make further assumptions about such matters as which party would make offers, the permissible amount of rounds of offers and counteroffers, how long each round took, whether either party had market power, what information the parties had or could infer about the other's desired price, and how much the delay cost each party.⁵⁰

That result relies on the usual assumption that the parties' goals remained constant over succeeding rounds of bidding. The dynamics of the bargaining process, however, might change the manner by which the parties evaluate possible outcomes. In a sense, the bargaining process is a competition to secure a greater part of the \$ 9,000 surplus. If the parties begin to consider the competition important in itself, rather than solely a means for fulfilling their original wishes, the bargaining could fall through. The bids may change the parties' goals.⁵¹ If buyer makes a low bid, seller may be insulted: Likewise, if seller rejects or responds with a high offer, buyer may be affronted.⁵² At some point, each might decide that she would not make any concession beyond a certain point. Seller might refuse to sell to buyer for less than \$ 106,000, although she would still sell to a different buyer for \$ 100,000. Similarly, buyer might not buy from seller for more than \$ 104,000, although she would still pay \$ 110,000 for a similar house.⁵³ In that event no range of agreement would exist. Even if such status competition does not end the negotiations, it could increase the transaction costs, by increasing the resources such as time, money, and aggravation that the parties expend on the negotiations. Thus, the costs of status competition in negotiation constitute both decreased gains from trade and increased transaction costs.

Negotiation over the price term is only one possible source of status competition. The parties would also need to agree on a number of other contractual terms. Considerations of status could also arise from matters such as who must raise a subject first,⁵⁴ whether objective standards to govern an issue existed,⁵⁵ and whether a party must change his or her position in the negotiation, thereby "losing face."⁵⁶ If every transaction had such hazards, the costs on trade would be great. The next section discusses how pervasive status

competition can severely interfere with trade, as a prelude to showing how default rules are one tool that reduces such hazards.

V. A stark example of status competition obstructing exchange

In order to set the issue in relief, we can turn to a society that lacked many of the social mechanisms that have developed in modern commercial society to ameliorate status competition in negotiation. Medieval Icelandic society provides excellent examples of the possible hazards of status competition. Although Iceland had a highly sophisticated legal system, it lacked certain legal and commercial elements that serve to reduce such costs in modern commercial society. Iceland demonstrates how pervasive and costly status competition can be, and thus, how important the various social and legal mechanisms that alleviate such costs are. As described in the sagas, Medieval Iceland ⁵⁷ had limited forms for the exchange of goods. Status competition, in the form of competition for honor at great risk and expense, further restricted the flow of goods, as the following condensed example drawn from Njal's saga shows. As the succeeding section will discuss, similar conflicts can cause negotiations in modern society to founder.

Gunnar Hamundarson was a great warrior, the head of an extended household and the leader of a formidable kin group. ⁵⁸ Gunnar's generosity and a famine combined to leave his stores of hay and food perilously low. ⁵⁹ He went with some of his kin to Otkel Skarfsson to attempt to purchase supplies. ⁶⁰ Otkel had ample supplies; his reserves were so full that some would spoil before he could use them. At this point, both the transaction cost analysis and strategic behavior cost analysis would predict that a mutually beneficial exchange would take place. The potential gain from the trade was large. Otkel had something, part of his supplies, that was worth much more to Gunnar, preventing starvation among his dependents, than it was to Otkel, watching it rot. Gunnar was willing to compensate Otkel for the supplies. In fact, Gunnar later offered to pay Otkel twice the value of the supplies. ⁶¹ Thus, Otkel could receive something that would not just replace the value of the supplies, but retain its value. The parties were face to face and ready for immediate exchange. Thus, transaction costs would not obstruct an exchange. Likewise, strategic behavior analysis would generally predict that two parties with such a potential surplus from trade, with one party having what we might call "market power", would arrive at an agreement.

Icelandic society lacked the wide array of mechanisms that facilitate exchange of hay and food today: commodity exchanges, supermarkets, etc. Nonetheless, the parties could have accomplished the transaction at issue with the limited, but powerful, forms of transfer available to them: sale; gift, which would be reciprocated in the future, or a hostile taking, whereupon the taker might voluntarily pay compensation. ⁶² Gunnar attempted the first two routes: he offered to purchase the supplies, but Otkel declined to sell. ⁶³ Gunnar then suggested that Otkel make a gift of the supplies, and leave to Gunnar the question of compensation. Although Otkel had no fear that Gunnar would make adequate compensation, he again refused. ⁶⁴ One of Gunnar's party then suggested taking what they needed and leaving its worth, but Gunnar declined to raid at that time and left without the necessary supplies. ⁶⁵ Consideration of status governed both parties actions.

If the sole issue were the value of the goods and the compensation the buyer offered, a mutually beneficial exchange would have taken place. Status competition, matters of honor and prestige, however, prevented the exchange. ⁶⁶ Status in Medieval Icelandic society depended on honor, and one's honor could rise and fall in every dealing with others. ⁶⁷ Honor, moreover, was not measured in absolute terms. Rather, one's honor was defined relative to others. ⁶⁸ One could lose honor by not avenging an insult ⁶⁹ or a blow, ⁷⁰ or by receiving a poor place at a feast table. ⁷¹ Accordingly members of Medieval Icelandic society paid, constant attention to matters of honor. In some instances this attention extended so far as offering to kill to keep the best place at a feast table. ⁷²

Considerations of honor attended each mode of transfer of goods. A gift conferred honor on the giver, but carried the risk that the honor could be lost if the recipient insulted the giver by reciprocating quickly, by reciprocating after a long delay, or not reciprocating at all. ⁷³ A sale could leave the parties' honor unchanged, but only if they managed to avoid several pitfalls. For example, characterizing a transfer as gift, sale, or hostile taking was a matter of interpretation. A gift might be seen as conceding to a threatened hostile taking. An offer to purchase could constitute a veiled threat to make a hostile taking. ⁷⁴ A refusal of an offer to purchase could represent a challenge to make a hostile taking, ⁷⁵ a challenge which could not be refused without loss of honor. Other pitfalls arose from the need to complete the transaction over time. Ordinarily, the buyer would not pay on the spot. Instead the buyer would arrange for future payment, which left open the risk of more insult in either deciding the terms of repayment or failing to follow those terms. ⁷⁶ Finally, refusing an offer to buy or the solicitation of a gift resulted in humiliation of the offeror. ⁷⁷ As the next section discusses, modern transactions suffer from analogous pitfalls.

The interaction between Gunnar and Otkel aroused many of these considerations. Otkel may have interpreted Gunnar's sincere offer to purchase as a threat to take. ⁷⁸ Thus, although it would have made both better off in absolute terms, could not accept the offer because he might have lost honor by yielding to a threat. Otkel may also have regarded the speed with which Gunnar raised the issue as a means of keeping a social distance and superiority. ⁷⁹ Again, accepting the offer would have meant acquiescing in that evaluation. Speed in negotiation, which would facilitate exchange in absolute terms, would interfere by raising questions of status. Considerations of status in the future could also have interfered with the immediate exchange. Otkel may have declined to make a gift because it would require him to establish a social bond with Gunnar, and thus, depend on Gunnar reciprocating in a manner that would not diminish Otkel. ⁸⁰ Finally, a person might forgo a mutually beneficial exchange in absolute terms in order to attempt to gain in relative terms: Gunnar's offers gave Otkel an opportunity to diminish Gunnar's honor simply by refusing him. ⁸¹ Such considerations are less likely to interfere with many of the transactions in a modern commercial society. The reason is not that modern people are any less concerned with issues of status. As discussed in the next section, parties can easily lose what they desire in absolute terms because they become derailed by considerations of their position relative to others. Rather, many more commercial and legal mechanisms exist today to facilitate trade with fewer risks of status competition. A contemporary Gunnar could simply go to a store and buy what he needed, with little risk that the merchant would refuse

to sell because of risk to their honor. By providing prices set by supply and demand rather than by individual negotiation, market prices have the effect of reducing status competition costs. Many transactions still require negotiation, however, and status considerations can cause negotiations to run aground. The next section turns to how writers on negotiation have identified a number of ways that issues of status interfere with negotiations. The section further examines how default rules in contract law can serve to reduce such status competition.

VI. How default rules reduce costs of status competition

This section will discuss how default rules of contract law ameliorate some pitfalls of negotiation by providing a given framework for exchange. One might compare it to the way that the existence of a market price makes it unnecessary for a buyer and seller to negotiate the price term. In the hypothetical above about a failed sale of a house,⁸² the status competition arose with regard to the purchase price. Buyer and seller began the negotiation concerned only about the price, but their concern shifted to a desire to win the negotiation, even at the risk of forgoing their original goals. For many transactions in modern commercial society, such status competition would not occur, because buyer and seller do not negotiate about the price. Rather, the market determines the price. Where goods or services are sold in a "thick" market, supply and demand set price and other key terms.⁸³ In such transactions, there need be no bargaining, and accordingly, no status competition to "win" the bargaining. Similarly, the market may set other terms of the contract. Indeed, contract law has recognized this by relying on "usage of trade" to provide default terms where parties do not agree on certain terms.⁸⁴ More generally, default rules may make it unnecessary for parties to negotiate about terms or may make such negotiation less likely to descend into status competition. Thus, default rules do not just reduce the transaction costs and strategic behavior costs of negotiation, but also help keep the parties' bargaining from leading to its own breakdown.

The more that potential contracting parties have to bargain, the more likely it is that they will seek to get a better deal in comparison to the other party as well as desirable contract terms.⁸⁵ In general terms, the more matters that are addressed by default rules that supply contractual provisions, the fewer stumbling blocks will arise in bargaining toward an agreement. Certain matters might be more sensitive to concerns of status, and thus especially apt to be addressed by default rules. For example, the U.C.C. imposes an obligation of good faith in every contract, although the parties may define what constitutes good faith for the purposes of their contract.⁸⁶ One justification for the rule is that the vast majority of contracting parties would want such a provision in their contracts, so including it automatically reduces transaction costs. Although this rationale has merit, the actual transaction costs saved are rather small because including a provision in the contract that the "parties shall act in good faith" would not be costly. A second justification, one of status competition costs, arises if we consider what it would take to get that provision into the contract. One party would propose that the contract require both parties to act in good faith. This might prompt the other to be insulted, as though her good faith had been questioned, thus invoking questions of relative worth on the scale of trustworthiness. The U.C.C. reduces such risks by including the obligation without the need for the parties to address the matter.

Similar considerations could affect mundane provisions, such as the rules governing remedies in the event of breach. If contract law did not supply damage rules by default, parties would have to bargain for damages. That, however, would require parties to state, in effect, "Here is what should happen if you breach the contract." The very suggestion that one party may breach could again arouse feelings of status. The U.C.C. avoids these problems by supplying such terms automatically.

Commentators have described a number of ways that the dynamics of negotiation may create what we have termed status competition. As with issues of status generally, economic analysis conventionally assumes away such considerations or consigns them to irrational behavior beyond the scope of economic analysis.⁸⁷ Discussions of actual bargaining, however, do confront such considerations. Negotiating to an agreement involves more than simply mechanically deciding the terms of the contract. Rather, the parties are likely to care not just about the final terms agreed upon, but also whether the negotiating process and final terms reflect well or badly on them. As negotiation has increasingly become a skill recognized in the curricula of law schools, lawyers pay increasing attention to such dynamics. A core consideration in negotiating is accommodating the opponent's desire to look good to others appear to have entered into a favorable agreement.⁸⁸ The process of bargaining can cause the parties' goals to shift "from mutual satisfaction to victory."⁸⁹ Negotiating texts are replete with techniques that negotiators use to address such problems and to prevent them from arising. Here I consider whether default rules may also serve to ameliorate such problems.

For example, it may be considered a sign of inferior status to raise an issue.⁹⁰ Conversely, where a default rule provides a term in the event that the parties do not address the matter, neither party needs to raise the subject. Negotiating for concessions presents another problem of status. Parties in negotiation frequently have a great aversion to making concessions because it implies defeat.⁹¹ An impasse may arise where a party has taken a position that it would be willing to change in absolute terms, but is unwilling to change its position because that will cause loss of status.⁹² Just as default rules make it unnecessary to raise a subject, they also make it unnecessary to change positions on a subject. Rather, the parties may decide to fill a gap with a default term. Thus, they provide a means to "save face."⁹³

In addition, default rules could provide objective standards. Negotiations have less the flavor of a pure competition if the parties can consider matters with respect to external objective standards.⁹⁴ Using objective standards can turn negotiation away from a "constant battle for dominance" which may threaten the negotiations.⁹⁵ The default rules, whose source is a court or legislature, represent an independent and authoritative source of the term at issue. Similarly, the default rule can at least provide a benchmark that may prevent extreme differences between the parties' positions. Empirical research shows that an extreme offer will likely elicit an extreme counteroffer which in turn, decreases the chance of the parties reaching agreement.⁹⁶ The existence of a default rule will likely make a party think twice before it takes the risk of making an extreme offer.⁹⁷

Default rules could also reduce status competition costs in a manner analogous to the way the Hadley rule discussed above prompted efficient disclosure to reduce strategic behavior costs. The Hadley rule prompts high-damage shippers to differentiate themselves from low-damage shippers by disclosing material information to the other contracting party.⁹⁸ Default rules could also elicit information relevant to status competition. Students of negotiation have differentiated between "competitive" and "cooperative" negotiators.⁹⁹ They also note that frequently one party is mistaken about the approach of the other party, and as a result, makes costly errors. In particular, cooperative negotiators may mistakenly assume that the negotiator they deal with is also willing to cooperate.¹⁰⁰ In some circumstances, default rules could help reduce this problem. Where a default rule addresses a matter, a party may indicate its position by the approach it takes. If a party asks for a rule more favorable than the default rule, that may indicate a competitive approach, while willingness to rely on the default rule may signal cooperativeness. Such signals are not as unambiguous as a high-damage shipper offering to pay extra in return for insurance, but nonetheless may reveal private information.

Thus, default rules serve to reduce possible conflicts in bargaining by alleviating the need to negotiate specific terms. This, however, could create tension with other functions of default rules. As discussed above, in some settings default rules reduce strategic behavior costs, creating an incentive to negotiate, and therefore disclose private information.¹⁰¹ In deciding what default rule should govern a particular matter, a lawmaker might need to decide whether the greater hazard is strategic behavior, which would call for a default rule that prompts negotiation on the matter, or status competition, which calls for a default rule that makes negotiation unnecessary. Such conflicts would be less likely with respect to transaction costs. In general, the same default rules would reduce status competition costs that reduce transaction costs. If the default rules supply the term that the parties would have agreed on then they need not negotiate about it which reduces both transaction costs and the chance of status competition. There could be a conflict in some settings, however. A court or legislature could choose a default rule that the majority of parties to such a contract would include. Similarly, the court could try to select a rule that is more likely to fit in a setting especially prone to considerations of status.¹⁰² Whether such tensions exist will depend on the nature of the contract and the parties. For example, contracts for sales of goods are likely to require a different approach than prenuptial contracts. Consequently, courts and legislators that formulate and apply default rules should consider the likely effects of the rules on the dynamics of negotiating various types of contracts.

VII. Conclusion

Default rules in contract law serve to reduce the effects of destructive status competition in negotiation.¹⁰³ Parties enter into contract negotiations in order to realize gains from trade. Presumably, if the negotiations result in agreement, then both parties, are better off. Negotiations may founder, however, if dynamics of the negotiation cause issues of status to interfere with the parties seeking a mutually beneficial exchange. Default rules fill gaps in contracts. In fact, sometimes negotiations may be less likely to fail if the parties do not need to address issues. Likewise, the use of default rules permits parties to not address an issue which the party

does not want to raise during negotiation or to concede to the other parties' position. Negotiations are also less likely to slip into status competition if the parties can refer to objective standards, which default rules may supply. In addition, default rules may aid parties in determining whether they are dealing with competitive or cooperative negotiators, and thereby avoid the costs of misinterpreting the actions of the other party. Thus, default rules function not only as a means to reducing the expenditure of resources in an exchange, but also to reduce the chance that negotiations cause their own demise. ¹⁰⁴

FOOTNOTES:

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¹ There has been considerable recent theoretical work on default rules in contract law, from economic, philosophical, and doctrinal viewpoints. See, e.g., Randy E. Barnett, *The Sound of Silence: Default Rules and Contractual Consent*, 78 Va. L. Rev. 821, 824 nn.10-19 (1992) (referring to recent theoretical discussions of default rules); Richard Craswell, *Contract Law, Default Rules, and the Philosophy of Promising*, 88 Mich. L. Rev. 489, 496-501 (1989) (addressing moral obligation of keeping promises); Laurence A. Cunningham, *Hermeneutics and Contract Default Rules: An Essay on Lieber and Corbin*, 16 Cardozo L. Rev. 2225 (1995) (suggesting hermeneutics could enrich study of default rules); Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. Legal Stud. 535 local cite (1990) (discussing default rules in commercial contracts); Richard Craswell, *Property Rules and Liability Rules in Unconscionability and Related Doctrines*, 60 U. Chi. L. Rev. 1, 7-15 (1993) (discussing choices in applying property and liability rules); Juliet P. Kostritsky, *Bargaining With Uncertainty, Moral Hazard, and Sunk Costs: A Default Rule For Precontractual Negotiations*, 44 Hastings L.J. 621, 672-689 (1993) (proposing rational handling of contractual goals through judiciary supplied default rule); see also Robert E. Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. Legal Stud. 597, 597-616 (1990) (commenting on Gillette's work regarding selection of default rule).

² See U.C.C. §§ 2-703 to 2-715 (1995) (covering sellers' and buyers' rights and remedies).

³ See U.C.C. §§ 2-509, 2-510 (1995) (addressing risk of loss without breach).

⁴ See U.C.C. §§ 2-314, 2-315 (1995) (addressing implied warranties of merchantability and fitness for particular purpose).

⁵ See U.C.C. §§ 2-308, 2-319 to 2-324 (1995) (defining commercial delivery terms).

⁶ See U.C.C. § 2-305 (providing for open price terms in contracts).

⁷ See U.C.C. § 1-102(3) (permitting parties to vary most terms by

agreement).

⁸ See *infra* note 13-20 and accompanying text (analyzing successfully resolution of financial aspects of transactions).

⁹ See, e.g., Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 *Yale L.J.* 729, 735-737 (1992) [hereinafter *Strategic Inefficiency*] (suggesting when costless contracting occurs, choice of default rules still matters); Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *Yale L.J.* 87, 88-95 (1989) (hereinafter *Default Rules*) (introducing theoretical design of efficient defaults); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 *Yale L.J.* 615 (1990) (arguing against established default rules).

¹⁰ See *Default Rules*, *supra* note 9, at 93 (suggesting contracting incompleteness caused by transaction costs). For example, some default rules could reduce the costs of judicial enforcement of contracts. *Id.* Default rules can induce parties to agree explicitly about matters that a court could later decide less efficiently. *Id.*

¹¹ See *infra* notes 38-56 and accompanying text (suggesting importance of personal status in negotiations).

¹² See *infra* notes 85-101 and accompanying text (highlighting competitive spirit in obtaining better deal).

¹³ See, e.g., Richard A. Posner, *Economic Analysis of the Law* 22 (4th ed. 1992) (stating Coase theorem established framework analyzing property rights assignment liability in economic terms); Robert Cooter & Thomas Ulen, *Law and Economics* 5 (1988) (analyzing Coase theorem interims of efficiency to parties); A. Mitchell Polinsky, *An Introduction to Law and Economics* 11 (2d ed. 1989) (asserting Coase theorem states efficient outcome occurs with zero transaction costs).

¹⁴ See Ronald H. Coase, *The Problem of Social Cost*, 2 *J. L. & Econ.* 1 (1960) (discussing Coase theorem and impact). There is no single canonical statement of the Coase theorem. *Id.* The article that introduced the idea never explicitly analyzed the theorem. *Id.* Rather, only as the analytical power of the article's analysis became clear as it extended to other areas of law did the analysis become known as the Coase theorem. More recently, it garnered its author the Nobel prize in economics in 1991. *Id.*

¹⁵ See Posner, *supra* note 13 at 51 (providing examples of just compensation in transactions).

¹⁶ Cf. Posner, *supra* note 13 at 95-96 (implying failure to impose efficient term results in increased and avoidable transaction costs); Polinsky, *supra* note 13 at 27 (opining contract rules desirable because costly to negotiate contract providing for all contingencies).

¹⁷ Cf. Cooter & Ulen, *supra* note 13 at 229 (suggesting fundamental economic problem of allocating risk of contingencies).

¹⁸ See Posner, *supra* note 13, at 95-96 (stating contract law achieves goal of efficiency).

¹⁹ See Restatement (Second) of Contracts § 204 cmt. d (1979) (discussing probability and reasonableness of supplying omitted terms) "Sometimes it is said that the search is for the term the parties would have agreed to if the question had been brought to their attention." *Id.*; see Richard E. Speidel, Restatement Second: Omitted Terms and Contract Method, 67 Cornell L. Rev. 785, 804-5 (1982) (describing Restatement rule as vague). Speidel states the rule appears "strangely isolated from the bargaining dynamics of the parties." *Id.* at 805. He provides an early analysis expressing some skepticism about whether such a rule lends any guidance to a court. *Id.*

²⁰ See Default Rules, *supra* note 9, at 89-95 (discussing economic analysis relying on "wouldhave" rule in disciplines of corporate, contract, and bankruptcy law).

²¹ See Ian Ayres, The Possibility of Inefficient Corporate Contracts, 60 U. Cin. L. Rev. 387, 389 (1991) (discussing methods for choosing efficient contractual defaults around which parties may negotiate). The use of game theory in the economic analysis of law is aptly described as part of the second generation of law and economics. See Randal C. Picker, Law and Economics: Intellectual Arbitrage, 27 Loy. L.A. L. Rev. 127, 128 (1993) (explaining need to evolve discipline of law and economics to keep pace with rapid changes).

²² See Strategic Inefficiency, *supra* note 9 at 736 (suggesting carrier's choices may influence strategic behavior of shippers); Default Rules, *supra* note 9, at 94 (revealing information withheld due to parties; strategic choices).

²³ See Default Rules, *supra* note 9, at 94-95.

²⁴ See *id.* (discussing strategic behavior parties engage in during contractual negotiation).

²⁵ See *id.* at 100 (stating informed parties may benefit by strategically withholding information).

²⁶ 156 Eng. Rep. 145 (1854).

²⁷ See Default Rules, *supra* note 9, at 101-02 (setting forth penalty default of not awarding unforeseeable consequential damages). The parties may not have wanted this result. *Id.*

²⁸ See *id.* (suggesting carrier more efficient bearer of risk so miller should have disclosed information).

²⁹ See *id.* at 103 (opining high-damage millers may intentionally withhold information making contracts more efficient).

³⁰ See *id.* at 110-11.

³¹ See *id.* at 102-03.

¶n32 See Default Rules, *supra* note 9, at 111 (noting carriers take low level of precautions).

¶n33 See *id.*

¶n34 See *id.*

¶n35 See *id.* at 109-10 (predicting high-damage millers should expect to bear costs of increased precaution and transactions).

¶n36 See *id.* at 103 (stressing courts should choose different defaults to counteract strategic information withholding behavior).

¶n37 See Avery Katz, The Strategic Structure of Offer and Acceptance: Game Theory and the Law of Contract Formation, 89 Mich. L. Rev. 215, 225 (1990) (distinguishing transaction costs from strategic behavior costs). Katz uses the terms "transaction costs" and "strategic behavior costs" as separate categories, but one can define the inefficiencies strategic behavior causes to count as part of transaction costs. *Id.* Thus, transaction costs could have two components: (1) costs of implementation which constitute the real resources used up in bring contracting parties together, in executing and administering the resulting agreement, in enforcing any bargain reached, and in settling any disputes that arise and (2) costs of strategic behavior which are losses suffered because bargainers have the incentive to maximize their individual gains rather than the total surplus from exchange. See *id.* at 225-26.

¶n38 See Richard H. McAdams, Relative Preferences, 102 Yale L.J. 1, 12 (1992) (noting analysis of preferences for position of ten deferred).

¶n39 See McAdams, *supra* note 38, at 12 (highlighting Thorstein Veblen as brave economist noting failure to recognize preferences for distinction). Veblen coined the phrase "conspicuous consumption" to explain "consumption for the purpose of creating an impression on others rather than for the satisfaction of need. . . ." The MIT Dictionary of Modern Economics 449 (David W. Pearce ed., 4th ed. 1992); see McAdams, *supra* note 38, at 12-13 & n.35 (discussing Veblen's criticism of classical economics' failure to consider individuals' desire for status distinction).

¶n40 See McAdams, *supra* note 38, at 28-44 (discussing studies and theories establishing people's interest in income and goods as symbols of status).

¶n41 See Arthur Lubow, Annals of Advertising: This Vodka Has Legs, The New Yorker, Sept. 12, 1994, at 62 (describing development of Stolichnaya Christall supreme vodka advertising campaign appealing largely to status).

¶n42 See Douglas G. Baird et al., Game Theory and the Law. A recent text notes "there is a vast experimental literature on bargaining which indicates that negotiating behavior does not always conform to the economic model." *Id.* at 242 (1994). Game theoretical models of bargaining typically assume for simplicity's sake that "rational" parties would not refuse offers simply because such offers are unfair or because the other party receives a better deal. See Avinash K. Dixit & Barry J. Nalebuff, Thinking Strategically: The Competitive

Edge in Business, Politics, and Everyday Life 45-46 (1991) (examining bargaining problem involving offers and counteroffers to reach an agreement); Eric Rasmusen, *Games and Information* 228 (1989) (applying standard economic theory to bargaining theory). Contract negotiations are not the only negotiations affected by such considerations. A recent article discusses experimental evidence of "psychological barriers to litigation settlement," including the effect of interpersonal comparisons on decisions about whether to agree to settlement. See Russell Korobkin & Chris Guthrie, *Psychological Barriers to Litigation Settlement: An Experimental Approach*, 93 Mich. L. Rev. 107, 143 (1994) (stating people act based on their perception of treatment by others).

¶43 See Posner, *supra* note 13, at 3-4 (explaining how man rationalizes his economic choices). Including considerations such as preferences and societal positioning in economic analysis of law may violate the assumption of rationality. See *id.* Economic analysis of law typically assumes that individuals behave rationally, in the sense that they attempt to maximize the satisfaction of their various wants with the resources available to them. *Id.* One might argue irrational behavior on the part of people who forego beneficial exchanges because they want to be the "winner" of the negotiation. See *id.* Economic analysis, however, has already securely accepted an analogous type of "irrationality"--risk aversion. See *id.* Many people would rather have \$ 10,000 than half a chance of winning \$ 20,000, even though both have an "absolute" expected value of \$ 10,000. In other words, many people in such circumstances are risk averse. See *id.* Economic analysis of the law has explored many ways in which the law serves to reduce or redistribute risk. See Polinsky, *supra* note 13, at 53, 59, 67, 79-80, 111-12 (incorporating risk aversion into analysis of each subject). Just as risk aversion causes individuals' valuations to vary, individuals' concerns about status similarly affect their valuation of goods, services, and of the transactions in which rights change hands. See McAdams, *supra* note 38 at 12 (discussing preferences and envy among people).

One might also argue that shifting from absolute to relative preferences is irrational in the more technical sense that the actor lacks "stable preferences." See Cooter & Ulen, *supra* note 13, at 234 (explaining how rational decision-maker can rank outcomes in order of preference). "Preferences that are too unstable to be represented by a utility function are irrational." *Id.* These shifts are consistent with a stable utility function. *Id.* An individual could rank preferences in descending order as follows: (a) making the exchange without competition; (b) making the exchange and "winning" the bargaining; (c) not making the exchange, but also not "losing" the bargaining; (d) making the exchange but "losing" the bargaining because the other party did better on the exchange. See *id.*

¶44 Roger Fisher, William Ury & Bruce Patton, *Getting to Yes* 5 (Penguin 2d ed. 1991). The authors, teachers of negotiation at Harvard Law School and Harvard Business School, were associated with the Harvard Negotiation Project. See *id.* at 199 (listing Harvard Negotiation Project's activities such as theory building, education, training, publications and action research); see also Alvin L. Goldman, *Settling for More* 177-78 (1991) (emphasizing how loss of respected status from embarrassment or humiliation may impede negotiations).

¶45 Jeffrey Z. Rubin, Conflict from a Psychological Perspective, in *Negotiation: Strategies for Mutual Gain*, 123, 127 (Lavinia Hall ed. 1993). Where the parties are locked into a conflict, the effect can be the most pernicious:

As the conflict escalates, there is a realization that both sides are going to lose and the more they stay in the game, the more they are going to lose. This results in an angry determination that the other side loses even more: 'We will both go down the rat hole but I am going to make sure that you go down first and a little bit further than I.'

Id.; see also Martin Shubik, The Dollar Auction Game: A Paradox in Noncooperative Behavior and Escalation, 15 *J. Conflict Resol.* 109 local (1971) (discussing classic game of such escalation); Schlomo Maital & Sharone L. Maital, *Economic Games People Play* 13-15 (1984) (explaining game of escalation wherein rivals compete to get top bid).

¶46 See. Michael C. Murphy, How to Sell Your Home in Good or Bad Times 90, 93 (1991) (advising house sellers conduct negotiations through agents because of emotions involved); see also Andree Brooks, Useful Ploys in Bidding, *N.Y. Times*, March 27, 1994, §10, at 5 (discussing how real estate bidding process may cause competing bidders to overbid in order to win).

¶47 Mark K. Schoenfield & Rick M. Schoenfield, *Legal Negotiations* 154-55 (1988) (recognizing negotiator's pride often prevents him from acting in client's best interest).

¶48 See *id.* at 155 n.118 (citing authorities dealing with face-saving). Such tactics allow parties to reach agreement without losing status. See *id.*; see also Philip Sperber et al., *Attorney's Practice Guide to Negotiations* 45-47 (1985) (discussing need of negotiating parties to have respect of other people). Although the parties' concerns about their status are often simply categorized as psychological, or emotional issues, this article seeks to show that economic issues exist as well. See Schoenfield & Schoenfield, *supra* note 47, at 157 (discussing inserting new issues to obtain economic concessions); see also Murphy, *supra* note 46, at 90 (discussing buyers need to win emotional component).

¶49 See Dixit & Nalebuff, *supra* note 42, at 205-20 (explaining brinkmanship concept of creating threat of disaster then forcing opponent back down). Game theory does, however, show that even if the parties remain concerned only about absolute preferences, strategic choices could lead to them foregoing a mutually beneficial bargain in some circumstances. See *id.* One party could adopt the strategy of brinkmanship, following a course of behavior that causes a risk of the negotiations falling through, to prompt the other to settle before the risk materializes. See *id.*; see also Thomas C. Schelling, *Arms and Influence* 99-105 (1966) (characterizing brinkmanship as manipulating shared risk of war); Thomas C. Schelling, *The Strategy of Conflict* 199-201 (1960) (discussing brinkmanship in terms of keeping the enemy guessing). One way a party could attempt brinkmanship would be to use status considerations: to conduct the negotiations in a way that intentionally created a risk of status obstructing the parties' bargaining. A party might also forego a beneficial

bargain in order to build a reputation as a hard bargainer for purposes of future transactions. See Baird et al., *supra* note 42, at 220 (discussing factors underlying party's choice of reputation as tough bargainer over benefit of deal).

¶50 See, e.g., Baird et. al., *supra* note 42, at 219-243 (discussing game-theoretic approach to noncooperative bargaining); Dixit & Nalebuff, *supra* note 42, at 286-301 (noting bargaining approach including game theoretic examples and rounds); Rasmusen, *supra* note 42, at 227-44 (describing game-theoretic bargaining approach involving economic theory); see also Katz, *supra* note 37, at 232-49 (outlining features of practical game-theory approach to bargaining).

¶51 See Carolyn Janik & Ruth Rejniss, *All America's Real Estate Book* 285-89 (1985) (discussing how pride and anger can interfere with bargaining and obstruct mutually beneficial exchanges).

¶52 See William G. Connolly, *The New York Times Guide to Buying or Building A Home* 187 (1984) (noting seller's pride often influences selling price of house).

¶53 See, e.g., JANIK & REJNIS, *supra* note 51, at 285-89 (listing examples of when seller's pride interferes with negotiation of house's sale price).

¶54 See *infra* note 91 and accompanying text (observing parties reluctant to make concessions).

¶55 See *infra* notes 95-96 and accompanying text (discussing considerations of status concerning negotiation issues).

¶56 See *infra* notes 92-94 and accompanying text (delineating negotiation techniques during contracting).

¶57 See generally William I. Miller, *Bloodtaking and Peacemaking: Feud, Law and Society in Saga Iceland* (1990) [hereinafter *Bloodtaking and Peacemaking*]. Miller makes little use of game theory or other economic tools. See *id.* at 32. He notes that the struggle for honor has been seen as a zero-sum game (on the theory that honor can be gained only at the expense of others). See *id.* An otherwise favorable review of the book by a leader in law and economics half-seriously faulted Miller for not using game theory. See Richard A. Posner, *Medieval Iceland and Modern Legal Theory*, 90 Mich. L. Rev. 1495, 1509 and n. 20 (1992) (noting Miller makes little use of game theory); see also Paul Campos, *The Untermensch as Übermensch*, 6 Yale J.L. & Human. 423, 427 n. 14 (1994) (reviewing William I. Miller, *Humiliation: and Other Essays on Honor, Social Discomfort, and Violence* (1993)). This recent book by Miller illustrates the Prisoner's Dilemma through the use of a story from the book. *Id.*

¶58 *Bloodtaking and Peacemaking*, *supra* note 57, at 84.

¶59 *Id.*

¶60 *Id.* Indeed, Otkel had such an abundance of supplies that a subsequent fire which destroyed part of his stores did not concern him. *Id.* at 86.

- ¶61 Id. at 81, 90.
- ¶62 Bloodtaking and Peacemaking, *supra* note 57, at 77-78.
- ¶63 Id. at 85.
- ¶64 Id. at 86.
- ¶65 Id. at 85-86.
- ¶66 Id. at 90.
- ¶67 Bloodtaking and Peacemaking, *supra* note 57, at 90.
- ¶68 Id. at 30.
- ¶69 Id. at 31.
- ¶70 Id. at 53, 61.
- ¶71 Id. at 30-31.
- ¶72 Bloodtaking and Peacemaking, *supra* note 57 at 90.
- ¶73 Id. at 82.
- ¶74 Id. at 86.
- ¶75 Id. at 88.
- ¶76 Id. at 81-82.
- ¶77 Bloodtaking and Peacemaking, *supra* note 57 at 89.
- ¶78 Id. at 87.
- ¶79 Id. at 86.
- ¶80 Id. at 88.
- ¶81 Id. at 91.
- ¶82 See *supra* notes 49-53 and accompanying text (setting forth facts and analysis of breakdown in negotiations for house sale).
- ¶83 See David D. Haddock & Fred S. McChesney, Bargaining Costs, Bargaining Benefits, and Compulsory Nonbargaining Rules, 7 J. L. Econ. & Org. 334, 334 & n.1 (1991) (explaining notions of "thick" and "liquid" markets). In a "thick market" or "liquid market" where there is a definite price for goods or services determined by market conditions bargaining is unnecessary. *Id.* If the market is "thin" or "illiquid," meaning that buyers and sellers negotiate prices and other terms rather than simply take the market terms, bargaining is

necessary. Id.

¶84 See U.C.C. § 2-202 (1997) (allowing parol or extrinsic evidence to explain or supplement but not contradict agreement's terms).

¶85 Of course, the converse may also be true, that building a relationship may make them well-disposed toward each other and increase the range of agreement. Id. But here I will address only the former effect.

¶86 See U.C.C. § 1-203 (1997) (setting forth good faith requirement); § 1-102(3) (1997) (prohibiting parties to contract from disclaiming good faith requirement). The general requirement of good faith is a mandatory rule that cannot be waived by the parties. See Default Rules, *supra* note 9, at 87 (noting duty to act in good faith immutable). The U.C.C., however, gives contracting parties considerable leeway to define what constitutes good faith. See U.C.C. § 1-102(3) (1997) (delineating when and to what extent parties may stray from U.C.C.). In large measure, the content of the duty of good faith presents a gap-filling, default rule.

¶87 Cf. Jennifer Gerarda Brown & Ian Ayres, Economic Rationales for Mediation, 80 Va. L. Rev. 323, 331-38 (1994) (distinguishing between psychological barriers to conflict resolution and strategic barriers created by rational parties). But see David Friedman, Less Law Than Meets The Eye, 90 Mich. L. Rev. 144, 147 (1992) (reviewing Robert C. Ellickson, *Order Without Law: How Neighbors Settle Disputes* (1991)).

¶88 See William Ury, *Getting Past No: Negotiating with Difficult People* 101 (1991).

¶89 Id. at 111.

¶90 See Zubin, *supra* note 45, at 123, 133 (observing each party's reluctance to initiate request for fear of appearing weak).

¶91 See, e.g., Fisher, Ury & Patton, *supra* note 44, at 29 (explaining people may decline to accept reasonable proposal to avoid appearance of backing down).

¶92 See Goldman, *supra* note 44, at 184 (contending cultural stigmas of weakness, indecisiveness or unreliability cause reluctance to retreat from concrete positions); Robert A. Wenke, *the Art of Negotiation for Lawyers* 14 (1985) (stating some people consider concessions sign of weakness); see also Howard Raiffa, *The Art and Science of Negotiation* 48 (1982) (advising negotiators to anticipate making concessions so party does not have to make all concessions).

¶93 Cf. Connolly, *supra* note 52, at 182 (recommending giving other side method to save face).

¶94 See Fisher, Ury & Patton, *supra* note 44, at 81-94 (developing strategy of negotiation based on objective criteria).

¶95 Id. at 83 (noting discussion of objective standards eases negotiation

process).

⁹⁶ See Frank H. Buckley, Three Theories of Substantive Fairness, 19 Hofstra L. Rev. 33, 48-50 (1990) (noting goal of negotiation to strike balance between extreme positions). Empirical research shows that extreme demands tend to cause extreme counterdemands and to decrease the chance of agreement. See *id.* 49-50 (1990) (citing studies). See also Raiffa, *supra* note 93, at 52 (discussing bargaining experiment where pairs of participants divide \$ 2). In Raiffa's experiment, the researcher instructed one member of each pair to hold out for \$ 1.20. *Id.* Frequently, this caused the other member of the pair to forego the 80 cents rather than agree to an unequal share. *Id.*

⁹⁷ Another possible legal response to the problem, at least in situations where one party still wants the deal to go through, might be to impose liability for bad faith in bargaining. Although such a cause of action has little judicial support to date, commentators have argued for such a rule. See E. Allan Farnsworth, Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations, 87 Colum. L. Rev. 217, 223-29 (1987) (suggesting liability for benefit of the bargain); Kostritsky, *supra* note 1, at 641-42 (encouraging liability for bargaining); G. Richard Shell, Opportunism and Trust in the Negotiation of Commercial Contracts: Toward a New Cause of Action, 44 Vand. L. Rev. 221, 235-45 (1991) (suggesting imposition of liability for precontractual negotiations). The use of default rules, however, has advantages over that approach with respect to this issue. Such a cause of action would require more than just a lost potential gain from trade. Otherwise it would create a general duty to sell one's property to anyone who valued it more than the owner. The plaintiff would likely have to show a substantial reliance interest and opportunistic behavior by defendant, both of which would be absent in many situations where status competition had obstructed a mutually beneficial bargain. In addition, default rules operate *ex ante* to prevent the problem, rather than *ex post* to attempt to repair it, which is likely to be more difficult to accomplish and harder to justify as efficient.

⁹⁸ See *supra* notes 33-36 and accompanying text (explaining Hadley rule fosters efficient behavior).

⁹⁹ See Gerald R. Williams, Legal Negotiation and Settlement 15-41 (1983) (describing results of large-scale study of practicing lawyer's negotiating patterns).

¹⁰⁰ *Id.* at 53-54 (focusing on cooperative strategy in attorney negotiations).

¹⁰¹ See *supra* notes 33-37 and accompanying text (analyzing impact of default roles on efficient disclosure of information).

¹⁰² Cf. Default Rules, *supra* note 9, at 124-25 (discussing court's difficulty applying gap-fillers where parties would have selected different terms).

¹⁰³ See Cooter & Ulen, *supra* note 13, at 99-102 (asserting purpose of law to remove obstacles of private bargaining) The authors state that a central purpose of contract law is to "minimize the obstacles to private agreements over resource allocation." *Id.* at 101. Cooter and Ulen term this principle the

"Normative Coase Theorem." *Id.*

¶104 Although contract law deals most directly with bargaining, legal rules may affect status competition in negotiation in other areas. For example, a model of bargaining to settle litigation typically will assume that parties consider the monetary value of the dispute, the parties' estimate of their likelihood of success, and the expected costs of litigation. See, e.g., Korobkin & Guthrie, *supra* note 42, at 111-116 (discussing empirical studies of settlement practices); Cooter & Ulen, *supra* note 13, at 481-92 (using game theory to analyze litigation and settlement); Rasmsen, *supra* note 42, at 60-65 (citing Strategic Behavior in Suit, Settlement, and Trial, 14 Bell J. of Econ. 539 (1983) (discussing model with asymmetric information based on Png game)). Parties in litigation, however, sometimes seek to obtain or avoid an injunction or damages award as well as victory over each other as an end in itself. Cf. Korobkin & Russell, *supra*; Robert Mnookin, Why Negotiations Fail: An Explanation of Barriers to the Resolution of Conflict, 8 Ohio St. J. on Disp. Resol. 235 (1993). Accordingly, one effect of the rules of procedure should be to turn the parties' efforts away from status competition.