I. Introduction and Overview

This book introduces and develops contract governance as a new approach to contract theory. It thereby aims at setting an international and interdisciplinary research agenda for a modern contract law. At its core, contract governance combines insights from governance research and contract theory. As an umbrella term, contract governance therefore covers various and very diverse issues of governance in contract law and contract practice—just as corporate governance does for company law and finance.

In this context, governance is defined as ‘the institutional matrix within which transactions are negotiated and executed’. Governance regimes are necessary where risks of opportunism occur or the interests of third parties are involved. In contracts, governance becomes relevant whenever the contractual agreement reaches beyond a mere discrete spot exchange, namely in long-term or network relations and where regulators employ the mechanism of contract to pursue regulatory goals. The latter aim can apply as well to masses of parallel spot contracts, as where, for instance, herd behaviour risks producing adverse effects. When analysing such phenomena, contract governance can obviously draw on a number of existing approaches such as institutional economics, incomplete contracts and relational contracting, networks of contracts theory, regulation theory and private ordering, elements of ordo-liberalism, and the insights of behavioural economics.

Governance research may well be seen as the scientific answer to major economic or state crises—which would explain as well why conceptions of corporate and

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2. O. Williamson, ‘Transaction-Cost Economics: The Governance of Contractual Relations’ (1979) 22 Journal of Law and Economics 233–61, 239 (and see also 235: ‘by governance structure I refer to the institutional framework within which the integrity of a transaction is decided.’)
public governance developed earlier and why the time may now be ripe for contract governance (see Section II of this Chapter). Contract governance proposes a scientific answer that is oriented towards the long-term and is principally aimed at overcoming the isolation of these different existing approaches to contract governance and thus strengthening both their theoretical coverage and their realism.

By bringing these existing approaches together, contract governance opens up new research perspectives. More importantly, contract governance approaches contract law in its entire width. While Williamson and subsequent governance research focussed almost exclusively on long-term contracts and on organizations (corporate governance), markets and exchange contracts require and depend on governance structures as well. After all, the global financial crisis has strikingly shown the third-party impact of contractual arrangements, and it has also shown that in the world of contracts, there is a high risk of mutual contagion because a modern economy is often arranged in networks. In financial markets, contractual transactions like collateralized debt obligations increasingly serve similar purposes to institutions such as credit banks, and the crisis has shown that market- and bank-based financial systems pose similar governance problems. In the Markets in Financial Instruments Directive (2004) (MiFID), a parallel phenomenon, stock exchanges and its contract-based alternatives, which in fact compete with stock exchanges, had been similarly regulated already in 2004. Therefore, Part II of the present work focuses on third party impact of contracting, while Parts III and IV on the network and on the long-term character of the phenomenon of ‘organization by contract’. Indeed, at a more fundamental level, exchange contracts on the one hand and long-term contracts on the other hand are not as fundamentally different as governance research hitherto seems to suggest. Both types of contracts do not pose entirely separate issues, but rather comprise part of a continuum. As a consequence, contracts as organization and contracts as exchange need to be seen and analysed within a common framework. Contract governance broadens the perspective accordingly.

Contract governance therefore stands for a holistic, comprehensive approach. It does so also in some other important respects. First, the governance perspective contributes to a genuinely interdisciplinary discussion. As opposed to law and economics, the range of disciplines that ‘collaborate’ has greatly increased, and

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these various disciplines contribute on an equal footing, gathering together into one discourse community. With this approach, under the paradigm of regulatory competition and by subjecting rule-setters themselves to a scrutiny of their incentives, questions of rule-making become paramount and turn into a genuinely ‘constitutional’ question.\(^6\) Beyond institutional economics, governance research includes various different perspectives: law and legal practice, sociology, psychology, and other behavioural sciences. In addition, if mutual consent is an alternative instrument of governance, it is paramount to take insights from contract theory and contract law into account. This broader interdisciplinary approach is what the book aims to illustrate in its overall arrangement. Secondly, contract governance takes a broader range of rule- and decision-makers into account. In addition to hierarchies, mutual and consensual forms of coordination and decision-making come to the fore. Part VI of the present work is devoted to this perspective. One of the central issues in governance theory is the interplay between external and internal impacts on decision-making in institutions (state or corporation)\(^7\) and the analysis of ‘weak spots’ within a scheme of collaboration, which is where governance arrangements are required.\(^8\) As in corporate governance, we can therefore distinguish external and internal mechanisms of governance, and as in general governance theory, the relevant structures include, but are not limited to, legal mechanisms. As a consequence, the substantive focus of contract governance is inherently broad, taking into account the different levels of rule-making, the different standard-setters, and the different rule-setting schemes and procedures. Finally, and as a consequence of the foregoing, contract governance takes advantage of broader circles of discussion. As in corporate governance, the discussion is not only interdisciplinary, but genuinely international, starting from an analysis of issues and considering solutions in national law or contractual practice as competing models. Moreover, contract governance links the classical contract law debate with modern regulation theory. Summarizing all this, contract governance research is holistic by nature with respect to disciplines, with respect to the discussion of standard setters, with respect to the discussion circles involved—contract law, market regulation, parallels in corporate law—and truly international.


\(^8\) This aspect is broadly taken up in this book in Part IV. Vulnerability (and a need for governance schemes) is seen if future developments are unforeseeable, but investments specific to this relationship (and not easily to be re-used elsewhere) are made (creating the risk of sunk cost if the relationship is terminated or if the other side devalues it by behaving opportunistically [moral hazard]), see Williamson, n 2, 233–61; O. Williamson, Markets and Hierarchies – Analysis and Antitrust Implications (New York/London: Free Press, 1975) et passim; O. Williamson, The Economic Institutions of Capitalism (New York: Free Press, 1985) 56–67.
The added value of contract governance, however, is not restricted to broadening the perspective. On the contrary, its broader perspective raises a whole range of new and innovative research questions. Not only are old questions often approached differently, but completely new ones become visible. For example, where the question is whether there is an alternative to mandatory regimes even where mandatory protection is desired, contractual and legal regimes of codetermination and workers representation can be compared and analysed. Such analysis promises to show less intrusive means of regulation.\(^9\) More generally, contract governance challenges the mandatory character of rules by understanding legal and contractual provisions as alternative possibilities of rule-making. Moreover, with its focus on external effects contract governance sheds new light on the market dimension of contracts, for example, with regard to the systemic effects of credit agreements. This approach diverges fundamentally from the very broadly accepted view of contract as producing effects exclusively or at least mostly amongst the parties alone. Conversely, a contract governance perspective proposes to study third party effects of, and on, contracts, positive and negative, in a systematic way, and not only with respect to contractual networks.

The present work approaches issues of contract governance by focusing on particular sets of such real world problems from the perspectives of various disciplines. On this basis, the book proposes to show two advantages of contract governance in more detail: (i) how a governance perspective leads to different and new questions, a good number of which seem to have been neglected in traditional contract law scholarship, and (ii) how these questions are dealt with in a different manner and style. We submit that a governance perspective helps to formulate questions more precisely and to discuss them more thoroughly, with a richer set of tools and possible outcomes.

This book addresses issues of contract governance in four areas:

(1) Contract and third parties: how should the legal framework for the drafting of contracts deal with the problem that different contract solutions have different impacts on third parties and third parties exert their influence on contract solutions? What are the biological, behavioural, and social science models behind this mutual impact (Part II)?

(2) Contracts and networks: how should the regime driving contract practice deal with the problem that contracts are often part of a larger network of relationships, which are both individual contracts and at the same time interdependent? What are the sociological and economic models behind such hybrids (Part III)?

(3) Contracts as organization: how should the regime driving contract practice deal with the problem that contracts, beyond individual exchange (as in the typical sales contract) may also have an ‘organizational’ function in that they may, and in modern market economies very often do, constitute the

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\(^9\) In a similar vein, see I. Ayres, ‘Menus Matter’, *University of Chicago Law Review* 73 (2006) 3, 4 (with the general goal ‘to change the world with less intrusive interventions’).
basis of (long-term) collaboration? What are the behavioural, sociological, and economic models behind such schemes of collaboration (Part IV)? All these topics are rather marginal in traditional contract law thinking—but not in current practice.

(4) Part V of this book concentrates on rule-setting as such, namely on (i) contract law and regulation and (ii) on contract law and contract drafting.

Before addressing these specific issues of contract governance, this Chapter addresses three cross-sectional themes, relevant for contract governance more generally and recurrent in the subsequent chapters:

(1) the relationship between the established fields of corporate governance and public governance and the emerging field of contract governance research (Part II);

(2) the issue of levels and of regulation (Part III); and

(3) questions of interdisciplinary discourse (Part IV).

Despite the cross-sectional character of this Chapter, Sections II and III already address the four topics which form the parts of this book: third party impacts, networks, the long-term character of contracts (Part III), and the issue of rule-setting (Part III).

II. Governance of Hierarchies and Governance of Market Relationships

1. Common ground between the governance perspectives

a. From public and corporate governance to contract governance

While governance research has developed richly since the 1970s in the areas of public governance and corporate governance where hierarchies and organizations are concerned, there has not been a similar development in the area of contracts where markets and cooperation are concerned. This is all the more astonishing as governance research is so strongly focused on the search for solutions to which all affected parties could have consented and on arrangements installed by the private actors themselves.

Hierarchies, of course, use state and supranational entities as paradigms. Indeed, the most prominent branch, based on general governance research, can be found in public governance. The term is highly heterogeneous, but in certain parts also closely linked both to contract and to corporate governance. Public governance

can be conceived mainly as governance of states.\textsuperscript{11} It is then mainly about the allocation and balance of public power. This involves important questions which are also relevant in other hierarchies, including the corporations, and which are therefore less telling for contract governance than corporate governance. Public governance can also be conceived as encompassing all mechanisms by which public law, namely administrative functions, are enhanced by consensus-based mechanisms, thus furthering co-operation between private actors and the public authority or among different public authorities in the search for solutions.\textsuperscript{12} This line of governance research has much in common with contract governance, namely the interplay between consensus-based design and the importance of the dimension of public good. In fact, while public governance would seem to be clearly focused on public good(s) in the typical case, it is exactly this interplay between consensus-based design and the dimension of public good that is also important for contract governance (and other branches of governance research in private law areas). As the remainder of this Chapter, and also the following chapters, illustrate one core aspect of governance research involves considering the private law side of contract design and the public regulation side as interdependent. This encompasses, in particular, private contract design and market stability; individual and institutional functions. The most important remaining difference might be that in contract and corporate governance, the aspect of public good is one of keeping intact a basically market-driven mechanism which is used for finding solutions while in public governance, the solution is not seen as one driven mainly by market mechanisms, but rather by (re-)distribution or adjudication, which in turn promotes the public good. The same issue can, of course, be seen as belonging rather to one area in one country and to another in the other one, as the example of the organization of universities illustrates.

On the private law side, one reason for the dominance of the corporation (hierarchy) in governance research may be that the most important economic crises in the G7, G8, and then G20 states centred around issues of the ‘firm’ and


thus company law. This may not be true of the Japanese and then Asian crises 1991/1992 and 1997/1998, but it was true of the crises in the UK and in the US (and also some other European countries) which have been the focus of much of the scholarly debates. These have concerned issues of control in companies (UK Cadbury Report and Code of Best Practice, now Corporate Governance Code) and in the area of annual accounts, responsibility within the company and their auditing in particular (Enron, Worldcom, Sarbanes Oxley Act). Some of the problems were mainly related to capital markets, but capital market law, despite its strong links to markets and contracts, can be seen as having an equally strong relationship with company law. In other words, company law research and accounting law considerations strongly integrate capital market law problems.

On the private law side, these circumstances may explain why corporate governance research developed so strongly while contract governance did not. The distinction is not, however, justified in substance. This development is largely due to historic coincidence—crises, but also certain features in the scientific

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communities dealing with the respective areas (see Section II(2) later in this Chapter).

In fact, contract and company (‘market and firm’) can be viewed as the two basic—and often alternative—instruments of economic planning and arrangements. Contract and corporation are the two elementary areas where economic players are invited to create their own designs via party autonomy, and conversely, they are also the two core areas where business regulation sets limits to (and thereby also additionally empowers) the use of individual autonomy (privatautonomie) and freedom of contract:¹⁷ The dominant form of regulation with respect to competition is antitrust law. Antitrust law has two main branches, control of cartels and merger control, i.e. contracts and companies. The dominant form of regulation of information problems and asymmetries are again clearly related to firm and market and have been developed because of this source of market failure. This is, on the one hand, capital market and accounting law in the area of company law (firms) and, on the other hand, consumer law with its information model in the area of contract law (markets).¹⁸ Both waves of regulation—and their imposition worldwide—follow important developments in economic theory with respect to the effects of competitive markets in the 1930s through to the 1950s (highly influential for Europe is the Freiburg School) and with respect to information economics in the 1960s and 1970s (from Stigler through to Akerlof and Spence).¹⁹ It would seem highly plausible that the idea of governance that has been considered in long-term relationships (and often in networks), i.e. in ‘organization contracts’ or schemes, developed in the 1970s and 1980s,²⁰ should and will follow the same path. In summary, both corporate and contract governance, are equally about individual, private party-driven design, and market regulation or, more generally, stability of organization forms and institutions.

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²⁰ See n 2.
b. Three common paradigmatic questions between corporate and contract governance

The parallels between firm and market do, however, not end at this rather abstract level. These are not only the two areas where party autonomy is paramount and perhaps the most developed and where certainly limits to and regulation of party autonomy are the most extensive and prominent. On the contrary, much more specific and nevertheless paradigmatic questions can be asked about both areas in a similar way, though hitherto such questions have been mostly directed toward corporate governance. The three fields of questions focussed in the present book illustrate the point. First, there is the relationship of the firm or the contract to third parties who are not part of the company or a party to the contract, respectively, but who are nevertheless affected by it or who can influence the relationship, be it negatively or positively. Secondly, the question can be posed of how can the relationships between a multitude of persons concerned be conceived—namely where such a multitude exists also in the setting of contracts—and how does the ‘constitution’ of these relationships influence the rights and duties and the governance arrangements in the overall design. This is the question of networks of contracts and relationships within (contractual and company) arrangements. A third question is about the duration of the relationship and its effects on the problems to be solved between all parties concerned. Arguably, the issues raised by long-term contractual relations are more similar to those of companies than to those of spot contracts, a proximity that would imply that one large part of contract law is closer to company law in its main problems than to the other, an important dividing line. Let us consider these three questions in more detail.

(1) Internal and external perspectives

The first question is about the internal and external perspectives. For corporate governance, it is evident and perhaps also the starting-point that instruments of internal and external governance are distinguished from one another and that their interplay is paramount.\(^21\) Thus, shareholder influence within the organization, namely in the general assembly (voice), is distinguished from shareholder influence outside the company’s organization, namely the influence they exercise via purchase and sale (exit; Wall Street Rule). Both dimensions are often intimately linked. Takeover law is paradigmatic for the interplay: the takeover bid to shareholders on capital markets, offering to buy their shares (exit, external governance) typically leads to a restructuring of the board as the core decision-making body within the company (internal governance).

A similar interplay of internal and external forces can be seen with respect to questions of the remuneration of management. From a legal perspective, the position of management has a company law dimension (position on the board) and a contract law dimension (contract for services for remuneration).

\(^{21}\) On the combination of internal and external governance, see n 7. For all this and the examples given (also takeover law) see also Grundmann, n 16, §§ 14 and 30.
Functionally, however, both dimensions are intimately linked which is already evidenced by the fact that remuneration has increasingly become the object of a complicated decision-making process within the company. Since the financial crisis, the relevance of remuneration for the economy as a whole, in particular, has been intensely discussed—on the grounds of its potential third-party effects (see Section II of this Chapter). This last example also shows how important the third party perspective is in the contract law context. Contract arrangements have just as much potential for negative external effects as remuneration schemes. In fact, the financial crisis is paradigmatic for a whole range of adverse external (third-party) effects that contracts may have. Nevertheless, third-party effects are only a minor research topic in traditional contract law doctrine, typically seen as being unworthy of systematic inquiry. The issue of third party-effects may, for example, shed a new light on the controversial (contractual) duty of responsible lending. The question is whether this aspect matters when the design of contract law is at stake, and whether there has to be a governance framework beyond the two parties. Similarly, securitization and the passing on of risks inherent in credit contracts via special purpose vehicles gives the incentive and the legal instruments to the first lender (creditor) to multiply the risks he can take. Moreover, is the design not such that redress to the first creditor (bank) who is the initiator of the product is interrupted while, in the area of sales of goods, Article 4 of the EC Sales Directive of 1999 had introduced a right to redress which the parties were not allowed to interrupt—not even within the B2B distribution chain? In a third step, it is clear that also a credit rating which is erroneously optimistic or disregards systemic risk can hurt not only the partner who contracted for the rating, but third (or fourth, fifth, ... ) parties as well—all this in a context where rating firms were subject to (usually undisclosed) massive conflicts of interests. Finally, how can the legal arrangement capture the phenomenon that parallel investment behaviour (herd behaviour) may transform individual risks into systemic risks, i.e. understand the phenomenon and develop a legal concept for it on the basis of (interdisciplinary) strands of theory? When is herding problematic, even though often it is seen as having positive effects?

Thus negative effects of contract drafting on third parties would seem to be a major issue of concern. At least four distinct forms can be identified in the chain of causation in the financial crisis—each of them interesting in and of itself but not discussed in depth in contract law scholarship: responsible lending; passing on of risks without retaining at least some responsibility; mixing of risks and thus inherently obscuring information; and credit rating under the influence of conflict of interests. All these have to do with the limits set by contract law, but influence market stability as well. Hence the question: can contract theory be amended so as to take the issue of market stability into consideration? A general reference to tort law has proved to be much less nuanced, insensitive to the problem that, in many cases, there is some kind of ‘implied promise’ involved between ‘tortfeasor’ and ‘victim’. Conversely, for the corporate governance debate—as previously in company law with its focus on creditor protection—adverse effects on third parties are a major research topic. The corporate governance debate indicates that
the full picture is worth discussing, with three more dimensions: **positive effects** of contracts on third parties as well as negative, or positive, influence **from third parties** on contracts. Again, the idea that even positive impact from third parties is worth being analyzed becomes evident when turning to corporate governance: of course, the positive effect which (potential) bidders in takeovers may have for disciplining management (already **ex ante**), is a major issue in the corporate governance debate. Likewise, could it not be that someday third parties—offering, for instance, ratings on fair behaviour—become a major factor in, say, markets characterized by long-term relationships, for instance franchise relationships?\(^2^{22}\)

Thus four dimensions of effects really have to be distinguished: contracts on third parties and third parties on contracts, both positive and negative. All four dimensions would have to be considered from a traditional private law perspective, from a regulatory perspective (antiitrust law being, of course, about negative effects of certain contracts, i.e. cartels), and in the private drafting process as such. In all dimensions, the legal framework can help to improve the outcomes, as evidenced, for instance, in the area of ratings. A contract governance approach would favour analysing the question in all three perspectives jointly—contract law, regulation, and the forces present in the drafting process. It would have to be asked at which level it is best to regulate and by which instrument. The financial crisis amply proved that legal and economic sciences are in crisis as well, namely with respect to seeing contracts too much in isolation from the world around. The disregard of third party relationships has a long-standing tradition—one major example being that fiduciary (‘trust’) relationships have not been conceived as contractual (having third party effects), but only as quasi-proprietary rights and effects.\(^2^{23}\)

In the present work, the external effects of contract—namely in situations of herding, as in the financial crisis—are discussed from various perspectives: from a biological/psychological perspective and from an economic perspective as well as from a legal perspective (in most cases with comments from other disciplines). Particular emphasis is placed on the contractual reconstruction of how potentially to internalize costs of external effects.\(^2^{24}\) In his contribution to this book, Micklitz starts out from the traditional teaching that external effects are to be caught by tort law only (which does not pay particular attention to the pre-existing relationships between all affected parties). Micklitz then asks how a liability regime could be reconstructed on a contractual basis, rendering parties to the contract liable to third parties, based on the assumption that there are networks of contractual relationships by which also those causing the external effects and those suffering the

\(^{22}\) See, for instance, S. Grundmann and M. Renner, ‘\textit{Vertrag und Dritter\textquoteright}’ (2013) \textit{Juristenzeitung} 379–89.


\(^{24}\) See contributions by T. Kameda and colleagues and P. Zumbansen (Chapter 2 and accompanying comment), by B. Frey and R. Cueni and by G. Teubner (Chapter 3 and accompanying comment), and by H.-W. Micklitz (Chapter 4). See also Section IV(3)(1) of this Chapter.
losses are linked at least indirectly (via a chain). This is the basis for asking how implied contractual arrangements between all parties affected could be conceived and how incomplete contracts could be reconstructed so as to reach commitments across the networks of contracts via presumed consensus.

(2) Networks of contracts
The second issue is that of networks of contracts (‘nexus of contracts’) — a concept found both in contract and in company law. In company law, the concept of a nexus of contracts is primarily employed to illustrate how each shareholder — and potentially also stakeholder — or any other player, for instance a manager, has individual incentives, but also rights and duties towards others. Thus, the concept is a perfect image of methodological as well as normative individualism. Based on this concept, it is easy to explain why the legal personality of the company as such does not prevent the existence of direct duties and rights between the different members. The concept of nexus of contracts, however, does not cogently explain whether all members have contractual relationships with all others individually (multi-facetted network) or rather with the company which administers the rights of all the other members in this respect (star-shaped form of nexus). The basic assumption of most laws would seem to be, however, that each member has the right to keep the ‘same’ proportional share in the profits (and, as a starting-point, also share in the decision-making power) and that each (other) member has the duty to respect this principle and not to gain hidden additional profits. The nexus of contracts is more heterogeneous and complex if stakeholders are included. Whether this is to be assumed is, of course, one of the core divergences which can be sensed in the corporate governance debate in different parts of the world, namely between Europe and the United States.


26 In this respect, it is an interesting development, for instance, that under the German Law on the Plc, in particular situations a fiduciary duty may even be owed by small shareholders to large shareholders: see mainly Bundesgerichtsho—Official Reports: BGHZ 103, 184, 194 (Linotype); case law of long standing tradition today, see for instance BGHZ 129, 136, 142–4 (Girms) (also small investors); BGHZ 142, 167, 169ff (Hilgers).

In contract law, the contractual relationships integrated into a network are manifold as well. Think, for example, of networks of suppliers, distribution chains, or in networks of payment systems or syndicated loans, all these constituting in some sense the backbone of the market economy. While all parties have a ‘shared’ interest in the existence and success of these networks, the jointly pursued purpose—with a pooling of inputs—and the common legal basis—a charter or articles of association—are less clearly defined. The core question is which modifications to general contract law are required to take account of the intended interrelation or network structure of the various contracts. Different legal instruments may come into play. So, for example, the remedies of the parties to the various contracts in a chain may be aligned, or a direct claim within a chain- or network-relation could be allowed—in modification of the general principle of privity. In both instances, general contract law is modified because of the existence of a network.28

Those inquiries dealing specifically with networks of contracts unanimously favour some kind of modification of general contract law. The (fairly recent) right to redress in the distribution chain provided for in Article 4 of the EC Sales Directive seems to indicate that legislatures (both on the Union and Member State level) in principle concur. What is disputed, though, is whether direct claims should be the rule or the exception or, conversely, a mere modification within the single contractual link. While important questions may have to be solved in different ways in contract and company law—for instance sharing of profits as the core principle in company law and split accounts, costs and income in the network of contracts—all core questions have to be asked in a very similar way both in company law and in the (network of) contracts setting: whether an added

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income which the network creates or added costs which it incurs should be shared by all; which decision mechanisms should apply (majority, unanimity/consensus); and which management powers should be delegated to one core decision body (such as the franchisor or the board) and which should be direct claims between the members. One thing is clear though: in each setting, party autonomy permit to a large extent the mimicking of the default rules of the other setting (in the charter or in the contract provisions).

In the present work, networks (of contracts) are also discussed from various perspectives: law, economics, and sociology. Again, many issues are inspired by the financial crisis. Gilson, Sabel, and Scott, for developing legal concepts in this context, focus on network arrangements between entrepreneurial innovation and the finance and other contracts needed for carrying this innovation to an end. They conclude that traditional contract law (namely US case law) is not well suited to cope with the governance of these contracts characterized by (highly unforeseeable, incalculable, yet innovative) situations of uncertainty and propose a more flexible system of networks of contracts (‘braided contracts’). Also chapters primarily focusing on third party effects—namely those of Frey and Cueni and by Teubner—cannot disregard network effects.

(3) Long-term relationships
A third set of questions is related to the long-term nature of the relationship—evident in the company law setting, but characteristic as well of many contractual relationships, namely those of organizational character. Two approaches are central—the theory of relational contracts and—in fact—general governance research as initiated by Williamson. Both approaches depart from a common starting point: the uncertainty of future developments and needs raises specific problems which fundamentally diverge from those posed by spot contracts.

29 See contributions by R. Gilson, C. Sabel, and R. Scott and by G. Hertig (Chapter 5 and accompanying comment) (the former also published in The Kauffman Task Force on Law, Innovation, and Growth: Rules for Growth: Promoting Innovation and Growth Through Legal Reform (Kansas City, Mo.: Kauffman, 2011); by R. Swedberg and by M. Amstutz (Chapter 6 and accompanying comment); and by M. Klausner (Chapter 7). See also Section IV(3)(a).


parties to spot contracts are mainly confronted with the uncertainty of whether the other party will perform. Consequently, the parties’ obligations can be described in a fairly complete way. A so-called complete contract, i.e. a contract regulating all potential developments, is more easily conceivable. For long-term relationships, on the other hand, a precise and exhaustive description of the core obligations is impossible, long-term contracts are inherently incomplete. This is the source of a particular set of risks of opportunism. More often than not, long-term relationships require high investments from one party or both and may thus lead to a hold-up situation where one partner can take advantage of the other partner’s sunk costs (or relation-specific investment), for instance, by demanding changes in the arrangement or by asking the other party to accept certain breaches. Conversely, there may also be a danger of holding the other partner too strictly to the agreement—for instance with respect to the conditions of termination of labour contracts or credit contracts or also partnership agreements. A termination regime which is too protective increases this danger.

Given the inherent incompleteness of long-term contracts, adjustment mechanisms are required. Various different instruments are at the parties’ disposal, and choice of the right one is a core governance issue. In all cases, procedure becomes paramount. Agency is a core instrument in this context—the basic model of a duty to decide in the interest solely of the principal which also applies in company law. This basic model reveals far-reaching similarities in the treatment of a contractual and corporate long-term relationship. The board’s fiduciary duty to further the interests of the company/shareholders is particularly prominent. It has been discussed extensively in the company context but much less in the context of contractual long-term relationships, even though the underlying questions are largely identical. In other words, the principal-agent theory which deals in particular with the question of how actions have to be taken in the interest of another person (or pool) should be seen as a theory of company and contract law. With respect to risks (and chances) resulting from the long-term duration of the relationship, the similarities between the contractual and the corporate setting are particularly evident and striking. The examples discussed in this context can equally be formulated as those of contract law. Take, for instance, the ‘Alaska Packers Case’—like in Williamson’s example, this case involved a workforce hired for a place in Alaska—which raised the issue of how proprietary rights and

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32 On this form of opportunism see references in n 6.
investment in housing, as well in the local retail store, should be arranged. The model of low search costs and high agency costs is well adapted both to the company law setting and to long-term contractual relationships—more or less depending on the degree of stabilization, for instance via termination prerequisites. It is always the legal shaping of the relationship—in the company law setting or in a contractual setting—which makes it adopt more of one characteristic than another, but the particular mix can be largely identical in contractual long-term relationships and in partnerships/companies with respect to termination prerequisites; the important question of compensation; inspection rights into the other actor’s actions; and decision-making rights.

In the present work, the long-term dimensions of contracts—namely fairness, reciprocity, and opportunistic behaviour—are again discussed from various perspectives. In other words, it investigates schemes of behaviour and then looks at these from an economic and from a legal perspective. In two case studies, Klausner develops the parallels between corporate and long-term (contractual) relationships, emphasizing their similarity as well as key distinctions. For long-term contracts, integration (pooling) of efforts and assets does not go as far leading to a situation where some problems are less pronounced (some players’ apathy), others more pronounced (hold-up situations), and many are very similar. The chapter focusses on governance mechanisms in long-term contractual relationships which can cope with or minimize, the problems resulting from hold-up situations and moral hazard. Gillette, in his contribution, concentrates on opportunistic behaviour devaluing firm- or relation-specific investments made by the other side or other parties. Starting out with an analysis of legal rules aimed at preventing opportunism and thereby encouraging relation-specific behaviour, Gillette—very much in line with what Williamson assumed—reaches the conclusion that such legal rules may not always achieve this goal. Judge-made rules, in particular, imposed ex post, may prove ill-informed or overprotective and thus provide room for opportunistic manoeuvre. This scepticism about rules is not completely shared by Schweizer who, while agreeing in principle, nevertheless sees a much more prominent role at least for default rules. The core of Gillette’s contribution is then about how parties can design their own arrangements to protect relation-specific investment. With regard to US law, Gillette concludes that courts too often adversely interfere with contractual arrangements of the parties. At least in a commercial setting, he argues, (virtually unlimited) deference to contractual governance schemes would be preferable.

35 Jensen and Meckling, n 33.
36 See contributions by S. Magen and by G.-P. Callies (Chapter 8 and accompanying comment) by B. Defains and D. Demougin and by F. Gomez (Chapter 9 and accompanying comment), and by C. Gillette and U. Schweizer (Chapter 10 and accompanying comment). See also Section IV(3)(a).
37 See n 6.
2. Is contract governance needed in addition to corporate governance?

If governance research seems to be particularly promising where contracts lead to relations which have a structure similar to that of a company, is not contract governance simply a plea for extending corporate governance? Could not corporate governance integrate the aspects of contract law? What is the added value of a genuinely contract- and market transaction-centred governance discussion?\(^{38}\)

First, the recent discussion of the financial crisis indicates that such an ‘inclusive’ approach would tend to disregard at least a good part of the important problems if, in a particular setting or crisis, the problems are mainly contract- or contract law-related. Secondly, a governance research agenda is important for contract and market transactions in order to fully profit from all the highly important tools and the changes in approach which a governance discussion brings about. The two-fold answer would then be that without contract governance, the discussion is too focused on the paradigm of the firm (disregarding the market), and without contract governance, all the changes in approach discussed are not fully exploited for contract law and in its market context.

a. Corporate governance not reaching deep enough into markets

Corporate governance covers a lot of material, but it does not reach deep enough into market transactions and contractual questions. Looking at how the financial crisis was dealt with would seem to be a good example. Again, market mechanisms (including contract drafting), default rules, and the mandatory framework have to be seen as different aspects of one overall governance scheme, taking into account its legal and interdisciplinary perspectives and paying particular attention to the (transnational) rule-setting scenarios.

For the regulatory framework in particular, it becomes evident that the focus is too narrow. One focus was on prudential supervision—and rightly so.\(^{39}\) Reforms

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dealt with (i) an increase in own funds, (ii) the question of how all institutions and tools which provide credit can be integrated into the supervisory regime, with extended supervision on a consolidated basis (also covering risks transferred to SPVs and short term guarantees provided for other group members), and (iii) supervision of market risks which can provoke problems similar to those resulting from the ‘traditional’ risk of non-diversification (‘agglutination risks’).

Beyond prudential supervision, however, the reform discussion focused on one ‘private law’ topic only: remuneration of management.40 This is certainly important and may even constitute a ‘systemic’ issue. If one considers the EU level though, binding legislation has been enacted in a sector-specific way only.41 The question why this particular issue attracted more legislative and academic attention than any other private law issue can probably best answered by referring to the fact that there had been a debate about remuneration before in the corporate governance discussion.42 In any case, not only could the remuneration issue have been considered also as a contractual one—certainly on the level of the brokers, but also on the level of management, as rooted in the contract between management and firm—but moreover this issue by no means exhausts the private law defects which lead up to the crisis. In fact, there are some issues which are clearly firm-related, others which are clearly market-related, and still others relating to both firm and market, such as takeovers and remuneration. Contract governance and corporate governance, not one or the other would seem to be the approach needed. And given that corporate governance is already so well developed, a crisis like the financial crisis which is now mostly related to deficits in the drafting of contracts is helpful in highlighting this rather obvious statement.


41 Directive 2010/76/EU; on this directive see n 39; for all listed companies, only recommendations have been enacted: Commission Recommendation 2009/385/EC complementing Recommendations 2004/913/EC and 2005/162/EC as regards the regime for the remuneration of directors of listed companies (K(2009) 3177, OJ 2009 L 120/28) and Commission Recommendation 2009/384/EC on remuneration policies in the financial sector (K(2009) 3159, OJ 2009 L 120/22); on these recommendations see n 3 (namely Hopt (2011) 1, 40–2).

42 See, for instance, G. Ferrarini and N. Moloney, ‘Executive Remuneration and Corporate Governance in the EU: Convergence, Divergence and Reform Perspectives’ (2004) 1 European Company and Financial Law Review 251–339; and first, in the UK in 1995, the Greenbury Committee, Directors’ Remuneration, n 14 (disclosure of remuneration and recommendation of an independent committee); and those named in nn 40 and 41. Quite lucidly in the sense that corporate and contract governance should be seen in conjunction in such cases: K. Riesenhuber, n 38, 64–77.
There are many other issues which would have deserved just as much, perhaps even more attention with respect to the repercussions on the overall system. For instance, would not a duty of responsible lending—as discussed in the legislative history of the consolidated EC Consumer Credit Directive—have prevented a consistent practice of issuing loans which were given to debtors who systematically did not even have the funds to afford the repayments out of their own income? Would not a mandatory redress rule or scheme—leading from any purchaser of a defective financial product up to the initiator—have prevented initiators from making such loans and then completely selling them off? Did not the lack of such a scheme of redress dramatically reduce the incentive to care about the creditworthiness of the debtors? This is not an abstract question either, given that such a mandatory redress rule does exist in Article 4 of the EC Sales Directive with respect to goods. It can be argued that such a redress rule is at least as appropriate for financial products. And finally, would not a mandatory disclosure rule—at least for all substantial conflicts of interest (like in Article 18 of MiFID)—have prevented rating agencies from structuring toxic bonds and at the same time rating them very positively (without such disclosure)?

Three main contract law factors constituting the chain which led to the financial crisis—sub-prime lending, a complete passing on of risks in distribution chains, and rating under conflicts of interest—were largely left undiscussed in the corporate governance dialogue—as well as in traditional contract law. A contract governance discussion would have been needed for this purpose. These aspects have, of course, been discussed as issues of regulation and prudential supervision. A governance approach would, however, have added the view that regulation and prudential supervision should not be seen in isolation, but in conjunction with their ‘private law’ side, i.e. the tools of contract law, on which the schemes were based. Thus, with respect to ‘the market’, private law and supervision were not seen together, as alternatives and mutually reinforcing each other. Such a holistic approach would, however, be needed also for market phenomena and also in a rule-setting perspective. It would indeed be helpful to ask—taking all alternatives into consideration—which level(s) and which substantive remedy to choose or whether the cumulation of different remedies or levels would be preferable, considering moreover how parties will probably respond to the alternative legal settings.


For ‘the firm’, i.e. for company law, such a discussion in mutual isolation—of the law of organization and of regulation—would not have happened to the same extent, and the corporate governance discussion helped in developing this more integrated perspective.

The discussion that has been summarized in the preceding paragraphs would seem to indicate that a corporate governance discussion does not reach deep enough into the market side of the question if the problem is genuinely contractual and that it cannot help contract law to develop the vision that indeed contract law tools and regulatory tools—from prudential supervision or investor protection—are to be seen as alternatives: both are capable of improving market structures and of contributing to their stability. As a matter of fact, it seems even peculiar that governance research did not first start in contract law. This is not only the area that is seen as the paradigm of any consensus-based method of problem solving and the ‘first’ area in traditional private law doctrine in most countries, but Williamson, when he coined the concept and also the term, took his examples mainly from this area.\(^4^5\) Theoretically, the development could have been just the other way around.

\[b. \text{Contract law in need of a governance approach}\]

If the first strand of the answer is mainly about the fact that corporate governance does not reach deep enough into market phenomena, the second strand is more about the status of contract law as such, to develop the potential of governance as a tool may well contribute to the modernity (also) of contract law. Contract governance studies can indeed be seen as a particular way to contribute to the modernization of contract law studies.

To this end, the three more concrete issues can be considered which form the core of the present work—contract and third party, contract and network, contract and long-term duration. This will be done in more detail later, but some comments are helpful here. An important aspect of modernization would be that of developing a more integrated view of regulation and private law in market transactions. This integrated view would seem to be indicated by the characteristics of substantive law and to correlate with recent trends, but it is still far from being mainstream in a contract law setting (or at least much less so than in company law). A first consideration would be that regulation can not be seen only as a limit to freedom of contract, but also as restoring the actual foundations—the prerequisites—for a meaningful exercise of party autonomy, thus contributing to rather than restraining it.\(^4^6\) Antitrust would then mainly be about restoring real freedom of choice and negotiation to the other side of the market, and consumer

\(^{45}\) See n 2.

law would primarily be about allowing an informed choice and negotiation by those contract partners who typically suffer from information problems and asymmetries, etc.

A second consideration would be that regulation and traditional private—in this context—contract law are furthering one common goal, i.e. free and informed choice in the process of formation of contract, but that they do so by focusing on different ways of cure, raising also different problems of proof, etc. One is looking at the overall market structure, the other at the individual position of (proprietary) rights of the parties but, by doing so, this, indirectly, also furthers overall market functions. Thus, regulation in antitrust law requires consideration of the relevant market and that for a good part of this market competition no longer properly works. On the side of regulation, no actual damage has to be proven. If, however, actual damage can be proven, the more recent trends show that there is no reason not to provide also compensation rights for private parties and even encourage action. On the other hand, in contract law settings, the effect on the whole of the market (structure) is not needed; it is not a core category in contract law, but rather actual loss (and lost gains). Third party behaviour may therefore be prohibited because it caused loss—destroying, for instance, a relation-specific investment—even if it did not reach the level of cartelization of whole markets. However, it may again be an argument to prohibit practices by third parties more easily if, in addition, they affect the market structure. Market regulation and contract law could then be considered to constitute what has been called in the German literature (with respect to public law and private law more generally) ‘mutually supplementary orders’ (gegenseitige auffangordnungen).

The third consideration would be that the first steps to close the gap between private law (contract) remedies and market regulation have already been taken.


With respect to the prime field of regulation, i.e. antitrust law, there is already a discussion and even a legislative procedure leading to a particular private law action for damages. It would be desirable to evaluate this trend and inquire more into the general repercussions such a trend may have. For example, what should be the private law actions for violation of regulation (including punitive damages), and what regulatory dimensions can influence interpretation of private law norms and concepts?

For a fourth consideration, one could refer to the old dispute on the nature of default rules: whether they should (primarily) aim at mimicking the assumed will of (the majority of) typical parties or at finding the equilibrium between the interests which the legislature sees as adequate for overall society, taking into account, of course, the preferences of the parties as well. For in fact, the result reached in a concrete contract can be seen not only as the result of a (bipolar) negotiation process between the parties, but also as a (triangular) process between the legislature as the author of the default rule and both parties. Contract law and regulation thus have a common goal but with differing approaches, different rule setters, different ways of imposing the standard, different levels at which the rules can be situated. Considering the interplay described and doing so from manifold perspectives as described—taking it as one mega-theme of contract law—would constitute a core feature in a contract governance debate to come. All this shows again that contract governance—just like corporate governance—is just as much about individual, private party driven design as it is about market regulation and stability or more generally, stability of organization forms and institutions.

The plea for a more integrated view of contract drafting, default rules, and market regulation exemplified by these four considerations is, however, at odds with powerful structural characteristics of contract law legislation and scholarship as they currently exist. A contract governance approach may also have been and may still be particularly difficult—and at the same time particularly needed—because of a marked heterogeneity in the subject matter and in the discussion and decision platforms. This is a consideration about the ‘contract law community’. First, the legislature would seem to be less ‘homogeneous’ in contract law than in company (and capital market) law. In the EU scenario, one Directorate General is responsible for company and capital market law, while for contract law several Directorates General are competent with fundamentally diverging ‘philosophies’, on the side of B2C contracts DG Sanco (with interests also in general contract law), on the side of B2B contracts DG Internal Market (lately also, for governance taxation) see F. Möslein, ‘Steuerrecht und Marktstabilität’ (2012) Juristenzeitung 243.

50 See n 128 and n 150 on the one hand and n 129 on the other.
all contracts, DG Justice). In the US, capital markets are mainly regulated under federal law with a strong supervisory and regulatory commission, the SEC, and company law is dominated by one trend setter (Delaware), whereas in contract law, competences are scattered among the states—with the important exception of the Uniform Commercial Code.

Similarly, the scientific community would seem to be less homogeneous in the contract law area, with a split between the ‘Civilisti’ and ‘Commercialisti’ (which, despite the Italian terminology, is a split which describes the status quo at least in most of the EU), the former primarily ‘responsible’ for contract law, but mostly neglecting important parts such as financial services (or other commercial) contracts and even more so regulation of markets, the latter often less integrated into the discourse community in core civil law. Within civil law, contract law is, moreover, typically combined with other civil law areas such as torts (thus forming the paradigm of a law of ‘obligations’), property or family law, rather than with other modes of shaping economic transactions via party autonomy, namely with company law. There are few typical common discussion platforms between ‘contract/market’ and ‘firm’ and not even between ‘contract’ and ‘market’. The same could be said of the courts. There would seem to be more of a trend to have only one leading court competent in company law, a court which guides and accompanies the discussion, which is certainly the case in the US with the Delaware Supreme Court, but also in some EU Member States like Germany and (at least in Germany) also very meaningful joint platforms between practice and academia. The same is more difficult to find for contract law and market regulation. Whereas company law—with its organizational and capital market aspects—is mostly discussed by the same circles of scholars and practitioners, the same is much less true of contract law—with respect to the contractual basis and the regulation affecting it. This status quo may also be influenced to a certain extent by the high heterogeneity of contract types, a consequence of its high degree of flexibility. While companies, associations, and partnerships all share a common aim, contract can be the basis of highly antagonistic and on-the-spot exchange, but also of very intense and long-term cooperation. Certainly, contract governance would need to aim at bridging gaps where they hinder the discussion needed. Contract governance discussion could act as a catalyst when developing a common methodological framework for this large variety of phenomena, which are currently still viewed as being too heterogeneous for such a joint discourse. Even better, a genuine contract governance discussion would probably not fail to develop the links to corporate governance—because they are twins in problems, party autonomy and its regulation, and they can be twins in their modes of discussion.

In fact, there is a continuum from the company law setting to the long-term contractual setting to the more short-term and spot contract setting, but also from market regulation to mandatory contract law to default rules in contract law. And seeing more of a continuum here would be one core challenge, but would as well be typical for a contract governance approach.
III. Multi-level Regulatory Perspectives

1. Levels of regulation

If, following Williamson, governance is defined as ‘the institutional matrix within which transactions are negotiated and executed’, the issue of the levels of regulation is at the heart of governance in general and of contract governance in particular. The example of the employment relation is a particularly suitable example to illustrate the issue from a legal perspective.

2. Levels of contract governance: employment as an example

If we look at private governance by the parties, there is, first of all, the employment contract. Yet, it is a characteristic of the employment contract as a long-term relation that not all the details of the mutual obligations can be spelled out at the beginning. Some aspects have to be left to renegotiation, but the central contractual instrument of adaptation is the employer’s managerial authority. In addition, there are other mechanisms in the vicinity of the managerial authority. Many aspects of work are determined by practice, custom or usage. An established usage may under certain conditions gain the quality of an enforceable promise. Other aspects are governed by autonomous agreement of a group of employees. Yet other aspects may be determined by standard terms or work rules.

At another level of autonomous governance, collective agreements govern the workplace. They are subdivided into different levels as well: some with nation-wide or industry-wide effect, others with effect for a company or a plant or shop-floor. They may be concluded by unions or by employees’ representatives of smaller units on the one hand and individual employers or their associations on the other.

See n 2.


Collective agreements can in principle be considered as part of private governance. Yet, they may serve as an instrument of public governance, too. With a view to established practice in some Member States, EU law provides for the possibility that directives in the area of social policy may be implemented by collective agreement (Article 153(3) of the Treaty on the Functioning of the European Union (TFEU)). Anti-discrimination directives encourage the social partners to adopt anti-discrimination programmes complementing public regulation (see, for example, Article 21 of Directive 2006/54/EC).

If we focus on public governance (in the sense of public ordering), again we find a multi-layered system. The regulatory cooperation of the EU and the Member States has already been indicated, as has the regulatory cooperation between public authorities and the social partners (on various levels). Regulation may take the form of substantive or procedural rules for the individual employment contract or relationship. It may also take the form of substantive or procedural rules for collective agreements. The EU’s ‘social dialogue’ procedure of Articles 154 and 155 of the TFEU is an example of an intricate mixture of public and private governance. Management and labour, the social partners, are involved in the legislative process from the beginning. They are being consulted on whether there is a need for EU legislation and on the form it should take; and they may request to be given an opportunity to regulate the issue by way of a collective agreement (‘framework agreement’) which then may be implemented by a Union legislative act. (This is an instance of ‘bargaining in the shadow of the law’—or a ‘regulatory threat’—and thus a private-public governance- and ordering-mix.)

At another level, issues of constitutional law, fundamental rights in particular, come into play. There are, of course, many established issues such as the prohibition of slavery and forced work or the protection of collective action as a fundamental right. Recent years have evidenced an increasing sensitivity—or sometimes inventory spirit—for issues of fundamental rights. An (in)famous example is, of course, the invention of a fundamental right against age discrimination in the Court of Justice’s Mangold decision. The long list of ‘fundamental social rights’ included in the ‘solidarity’ chapter of the EU’s Charter of Fundamental Rights (ChFR) has raised expectations—although the vague and deferential wording (in itself an example of multi-level governance) of almost all of the ‘social rights’ confirms their limited reach.

56 For a survey see K. Riesenhuber, Europäisches Arbeitsrecht (Heidelberg: C. F. Müller, 2009) § 4 paras 26ff.
60 See, e.g., Case C-323/08 Rodríguez Mayor [2009] ECR I-11621 paras 58ff (concerning Art 30 ChFR).
3. Aspects of contract governance

Levels of governance raise a multitude of—often conflicting—issues. The large number and disparity of issues leads to the question of meta-governance: how can conflicting governance issues be resolved? We will briefly address this latter issue in Section IV.

a. Coherence

The multi-faceted and multi-layered governance structures in the area of employment law lead to the problem of maintaining coherence. Means to this end may be a clear demarcation of the various levels, for example by supremacy or conflict rules or—for the overall body of law at transcending levels—a pre-structuring in substance by principles.

In this work, Hugh Collins’ contribution gives an illustration of the issues involved from another field. If courts from different jurisdictions decide differently on the recognition of a charge over property by way of security for a loan, this may be considered an issue of horizontal levels. As Collins suggests, the issue may also be discussed as a matter of ‘global law’, i.e. a level on the vertical scale. Such global law can, in this instance, however only be found in the ‘law’ that the parties created, a lex mercatoria. And while such lex mercatoria may claim a higher position in terms of its geographic scope of application, national conflict laws (and thereby also national and supra-national substantive laws) assume a higher position in the hierarchy of norms and—certainly traditionally—refuse recognition of such ‘private laws’ or, in any case, do not without reservation allow their derogation of mandatory national provisions.°

The governance response to the issue may be different, depending on how we view the reliability and responsibility of the parties concerned, resulting externalities and other public policy issues that public regulation is intended to accommodate.

b. Fundamental rights

Among the principles for the demarcation of different levels of governance, fundamental rights may be particularly prominent and high up in the hierarchy. There are fundamental rights of various actors to be taken into consideration. At the outset, the individual liberty—freedom of contract—of the contracting parties is concerned.°


° See the different approaches by H. Collins and H. Eidenmüller (Chapter 12 and accompanying comment).

but a fundamental right that is reinforced by every individual’s right to respect for his dignity. Focused on regulation, governance theory always has to assure that it respects individual liberty instead of only using individual contract to a regulatory end.

Employers and employees enjoy freedom of association. The more recent collections of fundamental rights grant employees as a group (or as a collective) rights such as the right to information and consultation (Article 27 of the ChFR). Workers and employers and their organizations have a fundamental right to negotiate and conclude collective agreements and, in cases of conflict, take collective action (Article 28 of the ChFR).

While the state or other public entities (such as the EU) do not as such enjoy fundamental rights, they may rely on the fundamental rights of, for example, employees to justify intervention. Indeed, they may be under an obligation to intervene in order to protect the fundamental rights of individuals or groups.\textsuperscript{64} Thus, for example, the Union or Member States may justify protection against unjustified dismissal under Article 30 of the ChFR (although, of course, the provision does not in a strict sense mandate regulation and does not constitute a competence basis).

c. Subsidiarity

Conversely, the principle of subsidiarity may be seen as a conflicts rule, albeit a hidden rule, arranging for interplay between the levels:\textsuperscript{65}

Under the principle of subsidiarity... the Union shall act only if and in so far as the objectives of the proposed action cannot be sufficiently achieved by the Member States, either at central level or at regional and local level, but can rather, by reason of the scale or effects of the proposed action, be better achieved at Union level.\textsuperscript{66}

While the principle is here spelled out with regard to the vertical division of powers between the Union and the Member States, it may also apply as between public and private entities and as between (private) organizations and individuals, for example unions and workers. Closely related to issues of fundamental rights—freedom of contract in particular—it provides for a presumption of competence of the smaller entity. Also fundamental freedoms may be seen as rules prescribing subsidiarity of state action as against action taken by private law subjects, thus prescribing subsidiarity for Member States and subjecting them to an outside scrutiny in this respect (by the European Court of Justice).\textsuperscript{67}


\textsuperscript{65} In a governance context, see recently Fleischer, n 54, 160, 168ff.

\textsuperscript{66} Art 5(3) TEU. For a recent (and critical) discussion see Möslin, n 51, 77ff.

d. Public and private levels

The issues of fundamental rights on the one hand and subsidiarity on the other also lead to the public-private divide. Subsidiarity, individual autonomy (privatautonomie) and freedom of contract can be construed as value judgments in favour of private governance as opposed to public governance and ordering. And indeed, recent years have evidenced a move to private governance also in the area of employment law.

Employee participation in the European Company (Societas Europaea) is a prominent example where mandatory public regulation (public governance and ordering) has been superseded by a system of contract governance. For no less than 30 years, repeated and creative attempts of the Member States to agree on a substantive regulation of employee participation in the European Company failed. The breakthrough came with a shift from the substantive approach to a procedural approach of regulation. Instead of providing a one-size-fits-all solution, the legislator opted for a negotiation model pursuant to which employee participation is to be determined, in principle, by way of agreement between the employer-side and the employee-side. The agreement is being negotiated by the representatives of the participating companies and a ‘special negotiating body’, formed specifically for the purpose of representing the employees—their number and their distribution over Member States—of the participating companies.68 (Note, incidentally, how the creation of the special negotiating body as well as the determination of the representation on the employer side again raises issues of governance.)69 The parties can determine employee participation according to their interests and needs—a custom-tailored solution. If they do not reach agreement within the prescribed period of negotiation, the fall-back solution annexed to the Directive applies. The system is mixed with a few mandatory elements with regard to the substance of regulation, a mandatory procedural framework, and considerable room for freedom of contract. The freedom to determine the employee participation is combined, though, with elements of incentives and ‘nudges’ as they result from the fall-back solution.

The same structure was subsequently employed for the European Cooperative Company (Societas Cooperativa Privata) and cross-border mergers. It is also the model discussed for cross-border transfer of the company seat and for the European Private Company (Societas Privata Europaea). Contract governance serves various purposes here. It gives back responsibility to the parties concerned, thus at the same time alleviating the legislature of a burden, re-empowering private parties, and providing for additional legitimacy of the employee involvement regimes

68 For a survey see, e.g., Riesenhuber, n 56, § 29 paras 31ff.
ultimately installed. Indeed, the negotiation model takes the idea of employee involvement a consequential step further than mandatory models. Negotiated employee participation promises to be better suited to the needs of management and labour in the individual firm. At the same time, procedural safeguards take account of the specific needs of the parties.

In this work, Pistor discusses how switching from hierarchical and coercive forms of governance in the area of global finance to ‘inclusive, horizontal, cooperative’ forms of governance—i.e. forms of contract governance—may contribute to improving existing structures. She uses the example of the European Banking Coordinative Initiative (EBCI) as a ‘full-fledged contractual governance regime’. Drawing on organizational theory, Pistor suggests that the predominant circumstances of uncertainty make contractual governance regimes superior in the financial markets. She expounds in more detail on the central elements—inclusiveness, horizontality, and cooperation—that characterize this model of governance.⁷⁰

\[\text{e. Democracy and representation}\]

Where collectives make rules, this may raise specific questions of legitimacy: democracy, self-determination, and representation. This issue is of considerable relevance also with regard to contract governance. Private rule-making in particular raises intricate issues of legitimacy.

A good (and still virulent) example is participation of the social partners—management and labour—in EU legislation under the social dialogue-procedures of Articles 153 and 154 of the TFEU discussed earlier.⁷² Originally, Parliament was not institutionally involved in this form of rule-making at all. Article 155(2)(1) of the TFEU now provides for a right to be informed. Legislation adopted in the social dialogue-procedure cannot draw democratic legitimacy from the European Parliament. The Court of First Instance (CFI) emphasized the necessity for the organizations involved to be representative for their constituents.

Another example is the posting of workers. Posting of workers raises intricate issues of legitimacy and representation on the horizontal level of the various Member States. For the posted employees who, purportedly, are to be protected by the application of the employee protection laws of the host Member State do not have a voice in the making of these laws or in the determination whether and in how far they should apply to them.⁷⁴
f. Competition and cartelization

Uniform rules at one level exclude competition at the lower levels. The cartelization of employees in unions was generally accepted in the latter half of the 19th century. On the EU-level, the Court in its *Albany* decision accepted that agreements concluded in the context of collective negotiations between management and labour in pursuit of social policy objectives are not covered by Article 101(1) of the TFEU. This does not exclude the possibility, however, that under fundamental freedoms, standard-setting that covers activities nationwide or even beyond is or might be scrutinized and struck down if amounting to an impediment.

Harmonization of laws of the Member States eliminates competition. Yet social policy legislation of the EU is (at least in principle) limited to minimum standards (Article 153(4) of the TFEU) and some areas, pay in particular, are exempted from EU legislation. Intra-Member State competition is strong where free movement of goods is concerned. Competition on the basis of employment standards is restricted though where free movement of services is concerned. In *Rush Portuguesa*, the Court accepted that:

Community law does not preclude Member States from extending their legislation, or collective labour agreements entered into by both sides of industry, to any person who is employed, even temporarily, within their territory, no matter in which country the employer is established.

While subsequent decisions have spelled out certain limits to a duplication of standards of employee protection, these limits are rather broad. They do not even coincide with the Union standards of protection. Thus, while EU law provides that every worker is entitled to four weeks of paid annual leave, the Court has accepted that the host Member States may extend this entitlement—in this case six weeks—for posted workers.

The Posting of Workers Directive (PoWD) responds to this judgment with an attempt to coordinate national posting of workers laws and make their operation transparent.

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Functions of workers' representation

If we look at workers' representatives, they may serve various functions. Much of the debate focuses on 'participation', 'representation', and 'industrial democracy'. Indeed, this relates back to the issues discussed earlier. Representation and voice are all the more important where decisions affect a person directly and where the exit option may be restricted. It is quite another issue, of course, whether the respective rights should be mandated by law or left to individual agreement. Let us briefly consider two other aspects: information and adaptation.

In various instances, workers' representatives mediate information. Take the example of the Transfer of Undertakings Directive (TUD). Article 7 of the TUD requires the employers, both transferor and transferee, to provide the representatives of their workers with detailed information about the transfer. The information is certainly too detailed for the rank and file employee. The workers' representatives serve as information intermediaries. While the information is detailed, channelling it through the workers' representatives alleviates the burden of providing it for the employer. The workers' representatives will usually be especially experienced and often specifically trained in handling such information. They will thus be in a position to ask (the right) questions and make additional suggestions. They thus serve similar functions as information intermediaries do more generally, for instance accountants or rating firms whose roles for corporate governance are currently debated. And again, as there is usually only one workers' representation forum, channelling information thus alleviates the burden that comes along with information for employers.

As a long-term relationship, the employment contract requires adaptation over time. Employee representation and the system of collective bargaining can serve as adaptation mechanisms. This is particularly obvious for collective bargaining over wages. But it also applies with regard to employees' representatives at the plant level and their rights to information, consultation, or co-determination with regard to issues of the workplace. As Windbichler puts it '[c]ollective agreements and codetermination at the shop-floor level serve as tools for the necessary redefinition of rights and obligations over time, i.e., they are part of a sophisticated contract governance system.' Other contracts, long-term contracts in

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82 See Section III(2)(d).
84 See survey and references in S. Grundmann, n 12, § 14, paras 43–5, 50–3.
85 See Section III(2).
particular, involve similarly intricate governance arrangements, for example franchise agreements.

h. Principal and agent

Levels of contract governance may also be analysed in terms of principle and agent.\(^\text{87}\) If we consider issues of employment law with a view to employee protection, who is the best agent of the employee's interests?

This could initially be the employee himself. The concern here is that he may not be in a position to adequately pursue his interest in the market. Yet, this requires more detailed analysis.\(^\text{88}\) Secondly, the employer may function as the employee's agent. While certainly the employer pursues his own interest and while, undeniably, there are numerous examples of the worst forms of exploitation there are, in a working market environment, also elements that induce or even force the employer to take the employees' interests into account. Thus, the employer constantly needs to attract employees and thus has to be interested in establishing a good reputation. Again, as the employer cannot control every aspect of his employees' work (thus being potentially exposed to employee-opportunism), he may use remuneration as an incentive to reduce this risk.

Let us pursue the example of employee remuneration that we have already encountered earlier a little further.\(^\text{89}\) Following the financial crisis, remuneration has often been discussed as an issue of corporate governance. Indeed, it undeniably is an issue of corporate governance where (a) the manager's remuneration is concerned or (b) remuneration (boni) is used as an incentive mechanism for employees whose work is essential (or whose misbehaviour may be fatal) for the company. Yet, remuneration may also be a pure issue of contract governance. So, for example, Akerlof has advanced the thesis that employers pay more than just market-clearing wages so as to induce their employees to excel in their work (as a 'counter-gift').\(^\text{90}\) Indeed, subsequent laboratory studies seem to support this


\(^{89}\) See also K. Riesenhuber, 'Vergütungssysteme unter dem Blick von Governance und Compliance' in V. Rieble, A. Junker, and R. Giesen (eds) Finanzkriseninduzierte Vergütungsregulierung und arbeitsrechtliche Entgeltsysteme (München: Zentrum für Arbeitsbeziehungen und Arbeitsrecht (ZAAR), 2011) 133ff.

theory. However, more recent empirical research casts doubt on these findings. It appears that above-market remuneration merely works as a short-term incentive. Governance needs to rely on interdisciplinary research, yet, the issues involved may be complex and difficult to prove or falsify.

Then there are collectives on the employee side. Unions and employees’ representatives in the firm recommend themselves as agents with their market power derived from the concentration of individual interests and cartelization. Their deficiencies as agent for the individual employee result from the standardization of solutions they offer—by which, on the other hand, they also may mediate between heterogeneous employees’ interests—and from the focus on the interests of those whom they represent. The standardization is likely to be over- or under-inclusive, depending on the individual interests and the individual ‘strength’ or market power. In any event, (mandatory) collective regulation is by definition heteronomous, thus infringing with the individual’s self-determination. A focus on, usually, those who are currently employed will often go at the expense of the unemployed. Or, conversely, taking into account of the labour market at large (including the unemployed) may go beyond the unions’ mandate.

Legislators and courts, too, have their deficits as agents of the employees. Again, employment protection is put in place for those who are employed and not for the unemployed. Protection of the employed makes entry into employment more difficult for the unemployed. Where courts view themselves as adjudicators who follow the mandate of the law, they will (inevitably) reinforce the same tendency.

i. Substantive and procedural regulation

While substantive rules provide for regulation on a given level, procedural rules do so to a lesser extent, providing only for a framework within which collectives or individuals may make their own rules. The framework may be more or less

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93 A parallel function of mediator is attributed to the (supervisory) board: see, for instance, the description by P. Davies, ‘Board Structure in the UK and Germany: Convergence or Continuing Divergence?’ (2000) 4 International and Comparative Corporate Law Journal 435–6, 450–5; E.-J. Mestmäcker, Verwaltung, Konzerngewalt und Rechte der Aktionäre—eine Rechtsvergleichende Untersuchung nach Deutschem Aktienrecht und dem Recht der Corporations in den Vereinigten Staaten, (Karlsruhe: C. F. Müller, 1958) 81ff; C. Steinbeck, Überwachungspflicht und Einwirkungsmöglichkeiten des Aufsichtsrats in der Aktiengesellschaft (Berlin: Dunker & Humblot, 1992) 45–54; this is common ground in comparative law (even if the board member represents a certain group of shareholders or even employees and has been nominated by that group): Wymeersch, n 27, 1079, 1091, 1132ff.
94 Picker, n 88, 353, 359ff.
rigid, providing for a guardrail, a (perhaps ‘threatening’) ‘shadow of the law’\textsuperscript{96}, an incentive, or a ‘nudge’\textsuperscript{97}.

We have already discussed employee participation in the European Company in the context of public and private levels of governance.\textsuperscript{98} It may also be considered from the angle of substantive and procedural regulation. EU employment legislation more often uses procedural elements. So, for example, the European Works Council Directive\textsuperscript{99} leaves prior agreements in place and was, indeed, the first directive to provide for a negotiation model. The Information and Consultation Framework Directive, too, leaves room for agreements of different ‘practical arrangements’. The Temporary Agency Work Directive provides for a mechanism to accommodate both employee protection and freedom of contract for collective agreements. Collective agreements may provide for less favourable treatment provided that they respect ‘the overall protection of temporary agency workers’ installed by the directive. The regulatory mechanism thus combines a broad range of freedom with a ‘global’ control mechanism. While it thus maintains flexibility, the obvious drawback is that the global standard of control is rather diffuse and difficult to predict, leading to legal uncertainty.

\textit{j. Complexity—of life and of regulation} \textsuperscript{100}

Complex issues may require complex rules—or simple rules. In the EU, rules appear to become increasingly complex, in particular taking into account the levels of regulation. New governance structures have to be evaluated with a view to existing structures, in particular with a view to an increasing complexity.

An increasingly prominent example is fundamental rights. Originally, the EEC (as it then was called) primary law did not provide for a catalogue of written fundamental rights. The situation was thus that the German Federal Constitutional Court, in its famous \textit{Solange I} decision, declared that ‘as long as’ \textit{(solange)} Community law did not provide for protection of fundamental rights, it would exert its own control under the German Constitution (the Basic Law, \textit{Grundgesetz}, of 1949).\textsuperscript{101} After the European Court of Justice in its jurisprudence developed fundamental rights as so-called general principles of EC law, the \textit{Bundesverfassungsgesricht}, in 1986, declared that it would not use its fundamental rights control as long as the Community maintained a standard of protection that

\begin{itemize}
\item \textsuperscript{98} See Section III(3)(d).
\item \textsuperscript{101} Federal Constitutional Court (\textit{Bundesverfassungsgesricht}, ‘\textit{BVerfG}’), \textit{BVerfGE} 37, 271.
\end{itemize}
was substantially equivalent to that of the Basic Law (Solange II). While the 1989 Charter of Fundamental Social Rights was rather a political declaration than a binding legal instrument (‘solemn press release’), the Charter of Fundamental Rights of 2000 has, since the 2009 Lisbon Treaty acquired the binding force status of EU primary law (Article 6(1)(1) of the Treaty on European Union (TEU)). Next to the fundamental rights as general principles and the fundamental rights of the Charter, there is further the provision of Article 6(3) of the TEU pursuant to which fundamental rights, as guaranteed by the European Convention for the Protection of Human Rights and Fundamental Freedoms (ECHR) and as they result from the constitutional traditions common to the Member States, constitute general principles of the Union’s law. So even on the level of EU law, there is a multitude of three distinct collections of fundamental rights, the (simple) general principles as developed by the Court; the ECHR fundamental rights, applicable as general principles; and the Charter fundamental rights. Next, there remain the fundamental rights of the national constitutions. And all Member States are, of course, also party to the ECHR so that its fundamental rights apply here as well. Finally, the EU has committed itself to acceding to the ECHR under Article 6(2) of the TEU. The multitude of regimes certainly may have its merit. So, for example, there may be good reason for installing an outside control so that the Member States or the Union may be subject to supervision by the ECHR (although, of course, that displays distrust in the constitutional courts). Yet, there are evident limits to control of control. And there is a downside to it, too. A multitude of regimes of fundamental rights and fora for their control opens room for manoeuvring: for cherry picking with a view to the fundamental rights sources or with a view to procedural issues. The multitude of sources may also invalidate the opt-out of Poland and the UK to the solidarity-rights of Title IV of the Charter. Indeed, it has been pointed out that in Viking and Laval, the Court refers to the Charter of Fundamental Rights—but not exclusively—leaving room for founding the right to strike on, say, general principles of EU law as well which would then be sufficient as a source for this right and thus make it applicable to these countries as well.

Anti-discrimination laws are another example. The irregularity that the principle of equal pay for men and women is provided for in Article 157 of the TFEU and thus in the ‘constitution’ of the EU has historical reasons. Yet, this has not been changed, irrespective of the fact that the Court has subsequently substituted the original economic rationale (competitive disadvantage of French business) to one of social policy. With the invention of a fundamental right against age

102 Federal Constitutional Court (‘Bundesverfassungsgericht’, ‘BVerfG’), BVerfGE 73, 339.
103 Cf Protocol on the Application of the Charter of Fundamental Rights of the European Union to Poland and to the UK.
discrimination as a general principle of EU law in Mangold, the Court has cemented this development—and, to a certain degree, insulated it from interference by the legislator. This is particularly noteworthy as the issue of age discrimination often involves difficult decisions of social policy—decisions that are best left to the legislator. The Court has, though, stopped short of recognizing more extravagant prohibitions of discrimination as general principles of EU law when confronted with the issue of discrimination on grounds of ‘socio-professional category or place of work’.

In EU contract law, the directive has thus far been the central instrument of contract governance (governance of contract law). As a matter of legislative technique, the instrument of a directive warrants revision as does the cooperation of the Court of Justice and national courts. Article 288(3) of the TFEU states that ‘[A] directive shall be binding, as to the result to be achieved, upon each Member State to which it is addressed, but shall leave to the national authorities the choice of form and method.’ It is thus an instrument of multi-level legislation. The idea seems captivating: let the central authority spell out the principles and the decentralized authorities make the rules. But first of all, that is not how it works in practice. Directives tend not to leave much room at all for interpretation by the Member States. But things get more complicated when it comes to implementation and application. Initially, interpretation and judicial development of directives follow their own rules. The multiplicity of language versions and a lack of common legal culture are two factors that make things complicated. Implementation of the rules is not enough. The principles of equivalence and of effectiveness supplement the specified rules of a directive, together with the *effet utile*, resulting in sometimes far-reaching—though not easy to foresee—consequences. And irrespective of the general concept of legislation in two steps, directives may under certain conditions be directly applicable, though only as against the Member States. The Court has, so far, resisted the temptation of recognizing a direct horizontal effect. But it has developed an obligation to construe the national law of the Member States in conformity with the wording and *telos* of the directive. While the theoretical development is clear enough, practical complication and confusion is unavoidable. This is certainly true for individuals subject to the rights and obligations determined by a directive, but also for national courts. Thus, for example, the limits of the obligation of interpretation

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106 Case C-144/04 *Mangold* [2005] ECR I-9981.
107 For a critical discussion, see Riesenhuber, n 58, 62–71.
110 See the survey in S. Grundmann, *Europäisches Schuldvertragsrecht* (Berlin: de Gruyter, 1999). Notable exceptions (now) are the meta-rules on the applicable law in the Rome-Regulations and the Group Exemption Regulations in EU competition law.
of national law in conformity with a directive are uncertain both on the EU level and on the national level. But this is not the end of it. Where collective agreements are used to implement a directive, there is yet another level involved. To be sure, the collective agreement then replaces the legislation. But the obligation of the social partners vis-à-vis the Member State does not relieve the latter from its obligations in relation to the Union.\textsuperscript{112}

4. Constructivism and evolution

Discussing even a few issues of governance makes us cautious and humble. Governance raises a multiplicity of complex issues and requires an interdisciplinary approach. Yet, in many areas, an \textit{ex ante} full-scale investigation into the issues involved from every angle concerned will arguably not be feasible (or not in this life). The example of Akerlof’s remuneration theory\textsuperscript{113} which has triggered a decade-long debate is sobering. More often than not, though, governance regimes are not created from a clean slate or at a clerk’s desk. Instead, they evolve over years in practice in a procedure of trial and error. The example also illustrates the importance of a factual analysis. It is not by accident that ‘empirical legal studies’ have gained considerable weight in academic debate in recent years. Indeed, empirical studies have to be considered an important tool in the governance discussion as well.

With Hayek, we should be wary of a constructivist approach to regulation.\textsuperscript{114} Regulatory restraint finds its basis also in respect for individual liberty. Moreover, the knowledge of the (state as) regulator is inevitably restricted. Contract governance, however, can help overcome both concerns to some extent. In the first place, contract governance is based on consensus. Rather than restricting individual liberty, it is based on individual decisions. Secondly, contract governance takes advantage of private information. Depending upon the circumstances, such information may well be superior to the knowledge of the legislator, namely with respect to very specific or particularly innovative subjects of regulation.\textsuperscript{115} On the other hand, however, private parties are for many reasons not necessarily in the best position to regulate themselves. It is therefore important to find an equilibrium between state-made, mandatory regulation, and private, contractual governance. Hence the real challenge lies at a meta-level and consists in designing a framework that allows for such equilibrium, restricting private autonomy (only) insofar as necessary while enabling private rule-making where adequate. In the

\begin{itemize}
\item \textsuperscript{112} Case 143/83 \textit{Commission v. Germany} [1985] ECR 427; Case 235/84 \textit{Commission v. Italy} [1986] ECR 2291.
\item \textsuperscript{113} See Section III(3)(h)
\end{itemize}
long-run, such a framework needs to be open for new, potentially better regulatory solutions. It must allow for evolution and innovation of norms, triggered by a dialogue between public and private rule-setters.\textsuperscript{116} Designing such a framework requires not only legal skills, but also insights from many other sciences—economics, sociology, behavioural sciences.\textsuperscript{117} Sure enough, there is reason to believe that Orgel’s second law prevails: ‘Evolution is cleverer than you are.’\textsuperscript{118}

IV. Multitude of Disciplines—An Equilibrium in Law

Governance—and contract governance in particular—is a quintessentially interdisciplinary endeavour. Governance provides a conceptual bridge that facilitates the dialogue across disciplinary borders.\textsuperscript{119} Even more, governance theory draws on insights from various behavioural sciences like sociological, political, and economic theory but also neurological and evolutionary sciences.\textsuperscript{120} Governance therefore provides a helpful tool for legal academics to learn from other disciplines. At times, traditional contract law scholarship may have taken other disciplines into account as well, be it as auxiliary tools or as standards of comparison.\textsuperscript{121} For contract governance, however, such interdisciplinary exchange and dialogue is no less than a core element—a plea to apply them as systematically as possible. Of course, most institutions that are relevant for governance research are designed by (legal) rules, and therefore legal scholarship plays a central role. Yet, governance theory does not limit itself to analysing the structure of such rules. The perspective on contractual and legal rules widens. In addition to the usual \textit{ex post} perspective on concluded events, it takes an \textit{ex ante} view: contract governance understands rules not only as an instrument of dispute resolution, but

\begin{itemize}
\item \textsuperscript{116} In detail, with respect to default rules, see F. Möslein, n 51, 2861, 2869–73; see also K. Pistor, \textit{et al}, ‘Innovation in Corporate Law’ (2003) 31 \textit{Journal of Comparative Economics} 676.
\item \textsuperscript{117} Recently, in a similar vein, see S. Deakin, ‘Legal Evolution—Integrating Economic and Systemic Approaches’, (2011) 7 \textit{Review of Law & Economics} 659–83; see also P. Zumbansen and G. -P. Calliess (eds) \textit{Law, Economics and Evolutionary Theory} (Cheltenham: Edward Elgar Publishing, 2010).
\item \textsuperscript{118} Named after the British chemist Leslie E. Orgel (1927–2007) and attributed to the British physicist and biochemist Francis H. C. Crick (1916–2004).
\item \textsuperscript{121} Generally on ‘plurality of methods as a challenge’ (translation by the authors) see S. Grundmann, ‘Methodenpluralismus als Aufgabe’ (1997) 61 \textit{RabelsZ} 423ff.
\end{itemize}
also as a mechanism for steering and coordinating human behaviour.\textsuperscript{122} Hence the governance perspective focuses on the steering effects of rules, necessarily taking into account the reactions of its addressees.\textsuperscript{123} The impact of such reactions depends on the character of the rules in question: the less hierarchical and mandatory, the more consensual and contractual the character of these rules, the more important the reactions of addressees for their very effectiveness. Human behaviour therefore plays a crucial role for the understanding, analysis and design of contract governance structures.

Once this interplay between rules and behaviour has been described in some more detail,\textsuperscript{124} the need for a dialogue with different behavioural sciences becomes obvious. Behavioural sciences provide models of human behaviour and therefore allow certain predictions about human reactions to specific rules. Contrary to a widespread assumption in the law and economics literature, behavioural sciences provide not just one, but various models of behaviour, differing in their assumptions and also in their predictions. Namely in view of rule-oriented behaviour, it seems paramount to take these differences into account. Contract governance theory therefore needs to draw on insights from a wide range of different behavioural sciences.\textsuperscript{125} More importantly, it needs to build on these lessons, taking them into account when conceptualizing legal and extra-legal rules, when predicting their steering effects, but also when designing the architecture of contract governance. Law, legal scholarship, and rule-setting therefore need to bring insights of various behavioural sciences into a specific equilibrium, considering and weighing their respective impact for every single regulatory context. The challenge is not just the application of these insights, but—ideally—translation and even informed choice between approaches—with a view to the institutional and factual settings encountered. This need becomes particularly obvious whenever governance faces phenomena that transcend the bilateral privity of spot contracts—in herding, networks and long-term contracts, the core features taken up in parts 2–4 later in this Section. Nevertheless, these insights are equally essential for contract law rule-setting in general—with basically the same overall challenge.\textsuperscript{126}

1. Governance: regulatory structures and human behaviour

Governance is about regulatory structures and human behaviour. Let us consider both aspects in turn. First, contract governance is about regulatory structures, consisting of legal as well as extra-legal rules. Generally speaking, governance is understood as the entirety of various collective impacts on a

\textsuperscript{122} Möslein and Riesenhuber, n 1, 248, 257.


\textsuperscript{124} See Section IV(1).

\textsuperscript{125} See Section IV(2).

\textsuperscript{126} See Section IV(3).
social system. The focus is primarily on institutions that shape and coordinate human behaviour. Such institutions largely consist of rules, be they formal or informal, legal or social, strict or flexible. With respect to contracts, rules at various levels shape the regulatory structure that may ultimately have an impact on individual behaviour. At the very top, the institutional framework for contract law rule-making consists mainly of constitutional rules, providing for procedural and substantive guidelines for designing contract law (governance of contract law). At a second level, contract law rules form an institutional framework that influences private contracting (governance by contract law). Contractual arrangements require this infrastructure of contract law, but to some extent, they are also influenced by this ‘shadow of contract law’. Contract law may thirdly pursue regulatory goals, steering individual behaviour (governance by means of contract law). Finally, contracts themselves provide an institutional framework, guiding and coordinating the future behaviour of the contracting parties. Therefore contracts are part of the regulatory structure of contract governance as well, even though they are provided by private parties, not by legislative bodies (governance by contract).

Secondly, contract governance is about human behaviour. One of the key elements of governance theory is its focus on how human actors make decisions, on their incentives as well as their utility functions, and on the feedback mechanisms between institutions and behaviour. While political and economic steering such as the ‘dirigisme’ of the 1970s—which understood control and regulation of a country’s economy and social institutions by the state as far-reaching—has largely proven unsuccessful and led to a veritable steering crisis of law (steuerungskrise des rechts), the idea of governance changed the perspective. Rather than systematically distinguishing between the state and private actors as subject and objects of such steering attempts, governance theory takes into account the interplay between the two, and thereby focuses on the interaction between

128 More extensively on these different levels Möslein and Riesenhuber, n 1, 248–89.
institutions (rules) and individual behaviour. In order to analyse this interaction, and to assess the impact and effectiveness of specific rules and regulatory structures, understanding human behaviour is fundamental.

The impact of human behaviour is even greater where the rules in question are not mandatory, strict and hierarchical in character, but optional, flexible, and driven by mutual consent. In other words, the softer the regulatory structure, the more important the reactions of private actors for understanding the functionality of the governance framework. This is because the impact of rules that allow for (certain) deviations is potentially limited. It depends on private actors following these rules at least to some extent, despite their margin of choice. While non-hierarchical rules are typical for governance in general, contract governance is particularly driven by mutual consent. In this perspective, contract governance is an extreme and very ‘pure’ form of governance, namely if one follows Williamson’s perception of the approach which implicitly and partly also explicitly favours the autonomous arrangements set up by the parties themselves. Such consent-dependency is, of course, obvious with respect to governance through contract, requiring the formation of a contract and therefore being literally built on mutual consent. However, mutual consent is equally important for governance by (means of) contract law. This area of law typically consists of default rules that are open for deviations by the parties. If parties are able to contract around default rules, however, law-makers need to take their expected contracting behaviour into account when drafting them. ‘By enacting a default rule to govern a contingency, then, lawmakers implicitly render a determination that the desires of the parties to a transaction will be permitted to take precedence over other policy concerns.’ As a consequence, parties’ preferences, their (hypothetical) consent and their contracting behaviour in general are widely regarded as a yardstick for default rules in contract law. More generally, the contract governance framework cannot be understood without analysing the behaviour of private parties. If they follow certain contract law rules blindly, without even thinking about contracting around them, but also if they take it only as a reference point, default rules become much more influential and can be designed much more

133 More extensively, see F. Möslein, n 51, 2861, 2875ff.
135 Möslein and Riesenhuber, n 1, 248, 258, 260; K. Riesenhuber, n 38, 61–83, 64.
138 Often quoted, for instance, Justice Oliver Wendell Holmes in Globe Refining Co. v. Landa Cotton Oil Co., 190 U.S. 540, 543 (1903): ‘[A]s people when contracting contemplate performance, not breach, they commonly say little or nothing as to what shall happen in the latter event, and thus the common rules have been worked out by common sense, which has established what the parties probably would have said if they had spoken about the matter’ (emphasis added).
autonomously by the law-maker.\textsuperscript{139} Hence the power of default rules ultimately depends on contracting behaviour.\textsuperscript{140} Even at the level of governance of contract law, mutual consent and individual behaviour play a certain role. In times that are often described as an ‘era of negotiated law’,\textsuperscript{141} the institutional framework for contract law rule-making itself becomes subject to private actors’ choices and preferences, at least to some extent. Parties can—and increasingly do—choose between different national contract laws, or between national and supranational contract laws (like the Uniform International Sales Law or a potential future Common European Sales Law).\textsuperscript{142} If contract law as a whole becomes optional, understanding parties’ choices is even more essential. In short, Contract Governance, the institutional matrix in which contractual transactions are negotiated and executed,\textsuperscript{143} cannot be understood without taking into account human behaviour.

2. Insights from social and behavioural sciences

Contract governance therefore requires interdisciplinary research. While legal scholarship tells us much about regulatory structures, it lacks a specific model of human behaviour. What is therefore required is a more intensive dialogue with other disciplines—not just economics, but social sciences more generally, in particular sciences of human behaviour, including neurobiology.\textsuperscript{144} Governance not only provides for a common language which greatly facilitates this dialogue,\textsuperscript{145} but even offers a unique opportunity for the social sciences to have a meeting point, if not for reunification, after their separation over a century ago.\textsuperscript{146} While the institutional matrix consists largely of contractual and legal rules, its functioning cannot be understood by legal scholarship alone. Contract governance may provide a tool to take advantage of much-needed insights from other disciplines. Default rules, situated at the meso-level of contract governance, may serve as a preliminary illustration for the potential of such interdisciplinary dialogue.\textsuperscript{147} By way of example, we will therefore address default rules several times.

\textsuperscript{139} In this sense R. Korobkin, n 137, 608, 675, concluding that the ‘[l]awmakers’ choice of default terms is likely to affect contracting parties’ preferences for substantive contract terms.’

\textsuperscript{140} See extensively Möslein, n 51.


\textsuperscript{143} See n 2.


\textsuperscript{145} See references at n 119.


\textsuperscript{147} In much more detail on this example see Möslein, n 51.
Economics provides for a specific, widely-used model of human behaviour, the so-called *homo oeconomicus*. This model corresponds with the theory of rational choice. It is based on the assumption that actors want to maximize their own utility. However, their ability to make rational decisions is limited by various restrictions, for example with respect to money, time, and knowledge. All possible options are evaluated according to subjective preferences. Conceptually, restrictions and preferences need to be strictly dissociated. Legal and contractual norms, however, cannot always be firmly allocated to one of these two categories. While one could well imagine legal rules and even self-imposed standards as restrictions, norms can also be internalized, thereby potentially modifying individual preferences. According to the traditional concept of rational behaviour, however, preferences need to comply with certain formal requirements. These requirements are designed in order to safeguard falsifiability and testability of the behavioural model. However, insofar as stable preferences are postulated, the possibility of internalizing new norms and social learning in general is severely limited. In any event, to decide rationally means to choose the option that maximizes subjective utility. Given that information about future events is limited, this decision has to be taken under uncertainty, on the basis of expected benefits.

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Applying this behavioural model to the example of default rules shows that utility-maximizing actors will agree on contracting around the default rule if one single actor can be better off without making anyone else worse off (pareto optimality). According to Coase’s theorem, rational actors will tend to allocate property rights by contractual agreement in a way that maximizes their subjective utility and provides for an efficient outcome. These actors will therefore contract around default rules whenever deviating arrangements are more efficient. As a consequence, the substance of such default rules proves to be irrelevant. However, this theorem depends on specific assumptions, namely on the escapist proposition that no transaction costs arise. Taking into account such transaction costs, default rules gain importance. Nevertheless, in this perspective default rules can only be legitimated if they facilitate efficient transactions, reducing their cost. According to the behavioural model of economics, default rules should therefore imitate the hypothetical consent of the parties concerned. Generally speaking, *homo oeconomicus* will contract around the default whenever this increases his subjective utility.

b. Sociology

Sociology provides another model of behaviour, entirely different from the forces which drive the *homo oeconomicus* are those driving the so-called *homo sociologicus*. The former is ‘pulled’ by the prospect of future rewards, whereas the latter is ‘pushed’ from behind by quasi-inertial forces. Hence external circumstances

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159 Pointedly already Coase, n 157, 1, 8: ‘The ultimate result (which maximises the value of production) is independent of the legal position if the pricing system is assumed to work without cost.’


serve as an aid to orientation. Behaviour therefore depends to a much greater extent on the social, moral, and legal context.

The social setting is regarded as the most important determinant for individual behaviour. It consists of ‘faits sociaux’, composed of social values and rules of behaviour.\(^{163}\) Legal rules can also rank among social facts, as long as deviations are sanctioned by negative social consequences (loss of reputation).\(^{164}\) However, social facts prevail only in the framework of certain social relationships, sharing common values and moral conceptions. A second important component of the sociological model of behaviour concerns the placement of individual actors in the coordinate system of such social relationships. Social positions can be achieved on purpose, but they can also be ascribed without any effort of one’s own.\(^{165}\) Each social position is tied to specific role expectations to which individual actors see themselves exposed.\(^{166}\) These actors are socially embedded.\(^{167}\) However, they do not follow such expectations blindly. In a world full of uncertainty, compliant behaviour can reduce complexity and stabilize expectations.\(^{168}\)

With respect to the example of default rules, *homo sociologicus* proves rather unresponsive to contracting around the default. According to the so-called normative paradigm, human behaviour is guided by role models and normative requirements.\(^{169}\) Similar to the Coase theorem, however, this paradigm is also based on certain assumptions. Norms need to be sufficiently institutionalized in

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164 In this sense already, see E. Durkheim, ‘*La Science Positive de la Morale en Allemagne*’ (1887) 24 *Revue Philosophique de la France et de l’étranger* 33–58, 113–42, 275–84, 278: ‘les mœurs, les coutumes, les prescriptions du droit positif, les phénomènes économiques en tant qu’ils deviennent l’objet de dispositions juridiques.’

165 See R. Linton, *The Study of Man* (New York: Appleton Century Crofts, Inc, 1936) 115: ‘Ascribed statuses are those which are assigned to individuals without reference to their innate differences or abilities. They can be predicted and trained for from the moment of birth. The achieved statuses are, as a minimum, those requiring special qualities, although they are not necessarily limited to theses. They are not assigned to individuals from birth, but are left open to be filled through competition and individual effort.’


order to establish identifiable expectations; they must also be sufficiently internalized in order to influence needs, goals, and attitudes of individual actors.\footnote{170} External institutions develop by circles of innovation, imitation and the creation of traditions, i.e. by a permanent process of socio-cultural objectification.\footnote{171} Internalization is effected by an adaptive process of trial and error.\footnote{172} As a consequence, only those rules that do not disappoint subjective expectations are internalized, but stand the test as an instrument for reducing uncertainty. Patterns of behaviour therefore develop in long-term individual and collective learning processes, driven by mechanisms of mutation and selection.\footnote{173}

c. Behavioural sciences

While these two models of behaviour seem to diverge significantly from each other, and perhaps even to be in diametrical contradiction to one other, both are theoretical models of social sciences, based on specific assumptions, focusing on specific interdependencies and thereby simplifying the complexity of human behaviour.\footnote{174} While specific outcomes of these models have been tested experimentally, they largely ignore the cognitive and neurobiological underpinnings of human behaviour. Behaviour, thinking, and choice are, however, outcomes that occur in the human brain.\footnote{175} It therefore seems important to take psychological and biological findings into account in order to understand how human decisions are made. Indeed, there is an emerging trend towards a biological science of making choices, integrating insights from cognitive psychology and neurobiology into economic, but also sociological models of behaviour.\footnote{176} In a similar vein, Kameda illustrates the relevance of

\begin{footnotes}
\item[171] Similar P. Berger and T. Luckmann, \textit{The Social Construction of Reality} (New York: First Anchor Book Editions, 1967) 55. 'Institutionalization occurs whenever there is a reciprocal typification of habitualized action types of actors. Put differently, any such typification is an institution.'
\item[172] In this sense Heiner, n 152, 560; V. Vanberg, ‘Rational Choice, Rule-Following and Institutions: An Evolutionary Perspective’ in U. Mäki, B. Gustafsson, and C. Knudsen (eds) \textit{Rationality, Institutions and Economic Methodology} (Oxon/New York: Routledge, 1993) 171, 173; see also Cross, n 152, and Knight, n 152, 229.
\item[174] These models are therefore aptly compared to searchlights, irradiating different and subject-specific aspects of human behaviour: K. Möslein, \textit{Der Markt für Managementwissen} (München: Deutscher Universitäts-Verlag, 2005) 56–86 ('Rationalitäts – und Fachdisziplin – Scheinwerfer').
\end{footnotes}
biological findings for understanding human behaviour, and Zumbansen qualifies contract governance as a conceptual bridge to improve our understanding of the relevant neural, psychological, and behavioural mechanisms.\textsuperscript{177} Most interestingly, neuro-scientific findings underpin both of these seemingly contradictory models, rather than confirming one and discarding the other. By means of functional magnetic resonance imaging, one can localize brain activities for specific decisions. Decisions tend to be made in two different areas of the human brain, the amygdala and the orbital and medial prefrontal cortex, and they follow different patterns accordingly. For instance, a recent study shows that human choices are remarkably susceptible to the manner in which options are presented when decisions are taken in the amygdala, whereas orbital and medial prefrontal cortex activity predicted a reduced susceptibility to such framing effects.\textsuperscript{178} In simple terms, the latter area of the brain would seem to follow the \textit{homo oeconomicus} pattern of behaviour, whereas the former would seem to decide largely in accordance with the model of \textit{homo sociologicus}.\textsuperscript{179} With respect to the example of default rules, contracting around them seems much more likely in the first case than in the second.\textsuperscript{180} To find out whether one or the other mode of thinking prevails under specific circumstances, however, certainly requires additional research and interdisciplinary exchange. In any event, it is crucial to consider both approaches to decision-making, one fast, intuitive, and emotional, the other slower, more deliberative and more logical. In short, ‘thinking, fast and slow’ needs to be taken into account.\textsuperscript{181}

d. Multidisciplinarity

Contract governance should likewise take both models of behaviour into account—and potentially even other disciplines as well. Rather than contradicting each other, these models are rooted in different research interests and perspectives:

Sociologists typically accuse economics for inappropriately emphasising \textit{choice} while ignoring the relevance of genuinely \textit{rule- or norm-guided behaviour}, and economists tend to criticise sociology for its preoccupation with norms and rules while ignoring the relevance of \textit{choice}.\textsuperscript{182}

\textsuperscript{177} Chapter 2 and accompanying comment.


Yet both models interlock. While the economic model does not take into consideration how preferences originate, the sociological model does not analyse how humans behave in the absence of norms.\(^\text{182}\) Both models therefore explain different aspects of human behaviour, and every human decision can be influenced by both kinds of rationality, but to different degrees. As a matter of course, economic and sociological theorists like von Hayek and Max Weber have taken both patterns of behaviour into account.\(^\text{183}\) Today, behavioural and identity economics\(^\text{184}\) as well as economic sociology\(^\text{185}\) contribute to their integration, partly under the telling designation ‘\textit{homo socioeconomicus}’.\(^\text{186}\) All this speaks in favour of methodological pluralism. Rather than presuming one single model of behaviour, contract governance should therefore consider insights of different social and behavioural disciplines, taking advantage of its capacity as a conceptual bridge and meeting point. “The recommendation is that, awaiting a unified theory, we should be accepting of pluralism.”\(^\text{187}\) It may even be that pluralism will (and should) always remain.


\(^\text{183}\) On the one hand, F. A. v. Hayek, \textit{Studies in Philosophy, Politics and Economics} (London: Routledge and Kegan Paul, 1967) 56 (‘But the rules of which we are speaking generally control or circumscribe only certain aspects of concrete actions by providing a general schema which is then adapted to the particular circumstances. They will often merely determine or limit the range of possibilities within which the choice is made consciously. By eliminating certain kinds of action altogether and by providing certain routine ways of achieving the object, they merely restrict the alternatives on which a conscious choice is required. The moral rules, for example, which have become part of a man’s nature will mean that certain conceivable choices will not appear at all among the possibilities between which he chooses. Thus even decisions which have been carefully considered will in part be determined by rules of which the acting person is not aware’); on the other hand: M. Weber, \textit{Wirtschaft und Gesellschaft} (Tübingen: Mohr Siebeck, 5th edn, 1980); \textit{Economy and Society} (Berkeley: University of California Press, 1968) 26 (‘It would be very unusual to find concrete cases of action, especially of social action, which were oriented only in one or another of these ways’).


3. Application to contract governance

a. An equilibrium of disciplines

The challenge of such integrated, multidisciplinary approach of contract governance consists in specifying the criteria that prove to be decisive for rule-related behaviour. A contract governance analysis needs to weigh these different criteria with respect to any single situation, in order to balance situation-specific equilibria of different methods, models, and disciplines. Empirical legal studies can help to carve out the relevant criteria.\(^\text{188}\) While they are multi-layered and highly complex, three major factors stand out: transaction costs, ignorance, and autonomy of individual preferences.

First, compliance even with ‘soft’ regulatory structures seems more likely as the transaction costs of contracting around rise.\(^\text{189}\) Such costs can arise as search and information costs (arising for figuring out or drafting alternative rules), as bargaining costs (arising for the respective consent with the other party), or as enforcement costs (arising for making sure that the other party sticks to the terms of the contract, and for taking appropriate action if this turns out not to be the case).\(^\text{190}\) The amount of these costs depends on a multitude of different factors, for instance on the availability of alternative rules. Whenever standard forms are widely used for certain transactions, switching from public-made contract law to this private-made regime is possible at very low transaction cost and therefore very likely. Different factors with an impact on transaction cost may compensate each other. Certain factors may also be influenced by the legislator.\(^\text{191}\) For example, to require potentially burdensome formalities for contracting around the default will increase transaction costs, so that private actors are more likely to stick to the standard regime.\(^\text{192}\)

Ignorance of private actors is a second important factor. While neo-classical economic theory assumes that information is easily available and easily processable, information and behavioural economics highlight its limits, for instance information asymmetries or decision-making based on heuristics.\(^\text{193}\)


\(^{191}\) See in more detail and with further references, F. Möslein, n 51, 335–437 (with respect to default rules).


\(^{193}\) See n 16 and n 171.
context of contract governance, ignorance plays a particularly important role because legal rules (and consensus about their application or about divergent contractual rules) necessarily point to the future.\textsuperscript{194} As a matter of fact, this future is unknown: ‘[i]f we are candid, knowledge of the future is a contradiction in terms.’\textsuperscript{195} In such a context, rule-guided behaviour is more likely because it helps to reduce uncertainty. Moreover, respective regulatory structures typically concern transactions’ auxiliary conditions. Actors will often tend to leave these auxiliary conditions aside and concentrate on the proper substance of the transaction. In many sales contracts, for example, parties will base their decisions on a comparison of product and consideration rather than taking the conditions of warranties into account.\textsuperscript{196} For cognitive reasons, choices are made by using simple heuristics, so that human actors turn out to be ‘one-reason-decision-makers’.\textsuperscript{197} For this reason, auxiliary regulatory structures are seldom challenged even if contracting around would be possible. Yet the degree of uncertainty might change. Individuals can have (‘good’ or ‘bad’) experiences and thereby learn to take certain auxiliary conditions into account.\textsuperscript{198} Such new information may well lead to a process of adaption that can ultimately challenge conventional regulatory structures.\textsuperscript{199}

\textsuperscript{194} One could refer to ‘constitutional ignorance’, a concept that goes back to F. A. v. Hayek, ‘Rechtsordnung und Handelnsordnung(1967)’ in F. S. Hayek(ed)Rechtsordnung und Handelnsordnung (Tübingen: Mohr Siebeck, 2003) 35, 45ff; in more detail on this concept see E. J. Mestmäcker, Regelbildung und Rechtsschutz in Markt- und staatlichen Ordnungen (Tübingen: Mohr Siebeck, 1985) 8ff; E. Hoppmann, Prinzipien Freiheitlicher Wirtschaftspolitik (Tübingen: Mohr Siebeck, 1993) 30; see also the monograph by H. Kunz, Marktsystem und Information (Tübingen: Mohr Siebeck, 1985) with the subtitle ‘Konstitutionelle Unwissenheit als Quelle von ‘Ordnung’ (‘constitutional ignorance as a source of order’).


\textsuperscript{198} At a glance, on respective psychological and neurobiological research, see M. Domjan, The Principles of Learning and Behavior (Belmont: Wadsworth, 6th edn, 2010); R. Kesner and J. Martinez (ed) Neurobiology of Learning and Memory (Oxford: Elsevier, 2nd edn, 2007).

\textsuperscript{199} Similarly, see Vanberg, n 181, 93, 107ff (decision-making as a ‘process in which our paradigms are constantly extended to new situations and modified in the light of experience’); see also Y. Choi, Paradigms and Conventions (Ann Arbor: University of Michigan Press, 1993) 47ff.
The third factor concerns the autonomy of preferences. The likelihood of contracting around the default depends on whether individual preferences depend on and are influenced by regulatory structures. Processes of internalization and institutionalization of specific rules would seem to have a potential impact on individual preferences. Preferences for specific legal or contractual rules might develop due to learning effects. They might also be rooted in psychological phenomena like the endowment effects or the status quo bias. Moreover, such preferences can arise because actors feel bound to these rules due to their social and cultural identity. Finally, the order of preferences, seldom a subject of economic discussion, seems very relevant. The more central a specific purpose, the more likely it is that actors behave purpose-rationally in this respect. In other words, while contracting around the default is quite likely with respect to rules that are relevant for purposes which are very important to the actors, it is much less likely with respect to rules that concern auxiliary purposes. Human behaviour corresponds to the model of *homo oeconomicus* in the first case, but it resembles to the model of the *homo sociologicus* in the second.

**b. A contract governance context**

With respect to contracts, multidisciplinarity and equilibria of disciplines will be required particularly whenever respective transactions go beyond simple, discrete

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201 In a similar vein, long ago, see A. Smith, *The Theory of Moral Sentiments* (London: A. Millar, 1759) 269 ("Those general rules of conduct, when they have been fixed in our mind by habitual reflection, are of great use in correcting misrepresentation of self-love concerning what is fit and proper to be done in a particular situation"); in more detail, A. Sen, *On Ethics and Economics* (Oxford: Basil Blackwell, 1980) 87ff.

202 Similarly, see R. Korobkin, *Behavioural Economics, Contract Formation, and Contract Law* in C.R. Sunstein (ed) *Behavioral Law & Economics* (Cambridge: Cambridge University Press, 2000) 116, 137 ("If lawmakers' choice of default terms alters parties' preferences for contract terms – causing an increase in the strength of their preferences for the default term and a decrease in the strength of their preference for alternative terms – the choice of default terms has the potential to affect any private contract").


spot contracts and contain relational elements. On the one hand, contracts for the immediate sale and delivery of spot commodities can still be quite easily explained on the basis of the economic model of behaviour. In principle, they can be decided on the basis of a very few identifiable criteria (price and quality), they constitute purely bilateral exchanges and they carry but short-term effects. On the other hand, whenever contracts are of a relational nature, be it because they are concluded under uncertainty, because they involve or affect third parties or because they have long-term bearings, then important governance questions arise. In the same instances, multidisciplinarity becomes an issue of even higher importance.

First, under conditions of uncertainty, humans tend to be highly socially receptive. To maximize utility on a rational basis proves particularly difficult whenever information is lacking, for instance in financial markets where important price fluctuations arise or where highly complex products are traded. Under such circumstances, collective behaviour gains importance, and this may now also be an issue for spot contracts because of their mass character. Individuals may learn from each other (wisdom of crowds), but they may also be influenced by others’ hysteria (herding effects). Kameda develops this idea in some detail. For fear of, say, bank-runs, public regulators may feel the need to prevent defective, maladaptive herding, but concurrently risk suppressing expedient societal learning, for both phenomena are underpinned by similar basic mechanisms. And integrating this idea then into a governance perspective, Zumbansen proposes that, as a conceptual bridge, contract governance can improve our understanding of the relevant neural, psychological, and behavioural mechanisms, and might thereby help to segregate the two contrasting collective phenomena. Such interdisciplinary understanding is no less than a precondition for designing effective rules to prevent herding effects, for example by encouraging countervailing forces like whistle-blowing, as is developed more broadly by Frey and Cueni.

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207 On relational contracts, see n 26.
211 Ground-breaking from a sociological perspective is G. Le Bon, The Crowd: A Study of the Popular Mind (West Valley City: Walking Lion Press, 1895); for the first contributions in economics, see Veblen and Leibenstein, n 206.
212 For more detail see Chapter 2.
213 For a broader discussion see comment accompanying Chapter 2.
214 See Chapter 3 and accompanying comment.
when courts decide on whistle-blowing, governance effects need to be taken into account. Indeed, the discussion of the *Heinisch* decision of the European Court of Human Rights has much to do with its ignorance of respective governance effects.\(^{215}\) But also in times where market stability is at the top of the legislative agenda in capital market regulation (to name but another example), understanding herding effects seems of paramount importance.\(^{216}\)

Secondly, third-party effects and more particularly the connectedness of contracts to a nexus raise similar questions, requiring a multidisciplinary analysis. Does the embeddedness in such networks change the behaviour of private actors? Given that every single contract stipulates self-imposed limits for future action, restrictions for individual future action cumulate and intensify. Additionally, however, preferences may also change, given that every single contract potentially changes the placement of individual actors in the coordinate system of social relationships.\(^{217}\) Respective contracts may well go beyond legal obligations and create new social relationships, with a potential impact on parties’ values and moral conceptions.\(^{218}\) Additionally, and under conditions of uncertainty, mutual confidence plays an important role in effective contracting which, as Swedberg develops in more detail, is likely to follow different patterns in a network as compared to bilateral relationships.\(^{219}\) Much depends on whether the aggregates have a simple cumulative structure and represent nothing more than the sum of their parts,\(^{220}\) or whether they have a more complex structure. In the latter case, discrepancies may emerge ‘between the motives of individual behaviour and the macroscopic consequences they provoke.’\(^{221}\) This observation, if true, would even call into question methodological individualism as the very cornerstone of rational choice theory, with far-reaching consequences for the governance analysis of contractual networks.

For long-term contracts, similar considerations apply.\(^{222}\) Again, embeddedness in social relations and mutual confidence play a much more significant role than in simple spot contracts. Additionally, uncertainty gains additional importance for long-term contracts pointing much further to the unknown future. The incompleteness of long-term contracts and their relational character have already


\(^{216}\) On market stability as legislative leitmotiv in the aftermath of the global financial crisis, see Möslein, ‘*Steuerrecht und Marktstabilität*’ (2012) *Juristenzeitung* 243.


\(^{219}\) Stressing the importance of confidence, with respect to financial markets, see Chapter 6.

\(^{220}\) Comment accompanying Chapter 6, Section II.

\(^{221}\) Comment accompanying Chapter 6, Section II.

been mentioned.\textsuperscript{223} Therefore, as Magen develops in some detail, issues of fairness and reciprocity are much more important than in simple spot contracts, and they seem to require multidisciplinary explanations.\textsuperscript{224} Beyond that, parties have to rely on social norms and common traditions in order to fill the contractual and legal gaps.\textsuperscript{225} Therefore they are likely to attribute major significance to (or maybe even to try to influence) the social and cultural identity of the other party.\textsuperscript{226} In labour relations, for example, such common values and social norms often lead to job performances that are much higher than required by the labour contract (‘partial gifts’).\textsuperscript{227} Last but not least, time patterns may even have an impact on the effectiveness of procedural settings. With respect to class actions, for instance, Defains and Demougin argue that intrinsic motivations based on morality may help to solve the problem of externality in the long-run.\textsuperscript{228} Beyond the subject of long-term contracts and inquiring into questions of long-term effects more generally, this observation underscores the importance of studying the long-term interaction of individual motivations and the legal environment. Focussing on the relationship between human behaviour and regulatory structures likewise accentuates the need for contract governance research.

V. Challenges and Perspectives

Contract governance certainly is a substantial challenge. As compared to traditional contract law theory, it requires a much wider perspective. It requires taking into account internal and external perspectives of contracting parties within the contractual relationship, but also on the market. In addition, it requires considering phenomena like herding, contractual networks, and long-term contracts. Moreover, it requires analysing a whole range of various levels of regulation, from the legislative sphere to collective bargaining and the individual contract. Last but not least, it requires a multidisciplinary approach, including not only economic, but also sociological and even neuroscientific knowledge. All this makes contract governance an extremely complex, but even more rewarding endeavour. This book is a first attempt to trigger such interdisciplinary discussion.

In the end, contracts themselves might turn out to be much more complex instruments than hitherto discussed. Yet this complexity makes them an even more interesting subject to study. While the global financial crisis has illustrated considerable risks of contractual relationships for the stability of (financial) markets, phenomena like innovation, privatization, and globalization show the limits

\textsuperscript{223} See text accompanying n 26 and n 201.
\textsuperscript{224} In a similar vein, Chapter 8.
\textsuperscript{226} In a similar vein, see Akerlof and Kranton (2010), n 184, 41–3 (with respect to labor contracts).
\textsuperscript{227} See n 86.
\textsuperscript{228} See Chapter 9.
of traditional national law-making. Concurrently, contracts come to the fore, inter alia, as an instrument of transnational regulation. In such an era of negotiated law, understanding contract governance becomes of paramount importance. Hence this venture promises to be worth every single effort. Can there be a better moment for venturing into this direction than now? The present book is, of course, only a first step.

\(^{229}\) In much more detail, and with respect to facilitative contract law, see Möslein, n 51.

\(^{230}\) See Mekki and Kloepfer-Pelèse, n 141.