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Opportunism and Trust in the Negotiation of Commercial Contracts: Toward a New Cause of Action

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I. INTRODUCTION

In a complex economy, many business transactions take place sequentially—one party performs in part or in full before the other side executes its side of the bargain. Sequencing has many advantages, but it creates an unfortunate incentive. Having received its benefit from the bargain, the party who is to perform last may be tempted to renege on its obligations. Law and economics scholars often describe the conduct of a reneging party in these situations as "opportunistic."[1] The reneging party, perceiving an opportunity to increase its gain, yields to temptation and refuses to perform. The law of contract helps to diminish the danger of opportunism by providing assurance to those performing first that their contracting partners can be held accountable if they renege.[2]

1. The term "opportunism" has a number of meanings that are explored more fully in Part II of this Article. *See infra* notes 22-27 and accompanying text.

2. By establishing penalties for nonperformance, the law gives parties the power to commit themselves credibly to future obligations. R. POSNER, THE PROBLEMS OF JURISPRUDENCE 50 (1990) (arguing that "the rules of contract law enable the making of commitments to buy and sell that unfold over time rather than being performed at the same instant"); Baird, *Self-Interest and Cooperation in Long-Term Contracts*, 19 J. LEGAL STUD. 583, 584 (1990) (asserting that the mutual suspicion arising from commercial situations in which parties cannot be sure whether the other

Accountability reduces the risk of entering business transactions and facilitates an atmosphere of confidence conducive to exchange.[3]

Recently, scholars have explored the dangers of opportunism even after a contract is formed.[4] If performance under the contract requires one side to invest in assets specially tailored to the transaction,[5] the other side may be tempted to exploit this postcontractual situation by renegotiating the original terms to capture more of the bargaining surplus.[6] The same postcontractual opportunistic incentives exist when one side becomes dependent on unique skills or knowledge acquired by the

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party will perform is "one of the justifications for contract law").

3. *See* Wisconsin Knife Works v. National Metal Crafters, 781 F.2d 1280, 1285 (7th Cir. 1986) (Posner, J.) (stating that "the most important thing which [the law of contracts] does is to facilitate exchanges that are not simultaneous by preventing either party from taking advantage of the vulnerabilities to which sequential performance may give rise").

4. The literature on postcontractual opportunism has covered an increasing number of legal topics. *See, e.g.*, Butler & Baysinger, *Vertical Restraints of Trade As Contractual Integration: A Synthesis of Relational Contracting Theory, Transaction-Cost Economics, and Organization Theory*, 32 EMORY L.J. 1009 (1983) (antitrust law); Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131 (1989) (lender-borrower relations); Gordon, *The Mandatory Structure of Corporate Law*, 89 COLUM. L. REV. 1549, 1573-85 (1989) (shareholder opportunism in the adoption of charter amendments); Graham & Peirce, *Contract Modification: An Economic Analysis of the Hold-Up Game*, 52 LAW & CONTEMP. PROBS. 9 (1989) (contract modification); Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L. REV. 927 (1990) (franchising); Johnson, *Correctly Interpreting Long-Term Leases Pursuant to Modern Contract Law: Toward a Theory of Relational Leases*, 74 VA. L. REV. 751, 783, 790-95 (1988) (leasing); Muris, *Opportunistic Behavior and the Law of Contracts*, 65 MINN. L. REV. 521 (1981) (contract modification, good faith in performance, tender of nonconforming goods, franchising, and penalty clauses); Narasimhan, *Modification: The Self-Help Specific Performance Remedy*, 97 YALE L.J. 61 (1987) [hereinafter Narasimhan, *Modification*] (contract modification); Narasimhan, *Relationship or Boundary? Handling Successive Contracts*, 77 CALIF. L. REV. 1077 (1989) [hereinafter Narasimhan, *Relationship or Boundary*] (renegotiation of successive contracts); Robison, *Enforcing Extorted Contract Modifications*, 68 IOWA L. REV. 699 (1983) (contract modification); Williamson, *Corporate Governance*, 93 YALE L.J. 1197, 1203 (1984) (governance of public corporations); Note, *Employer Opportunism and the Need for a Just Cause Standard*, 103 HARV. L. REV. 510 (1989) (termination of at-will employees).

5. These investments are labeled "contract-specific" or "transaction-specific" assets. *See* Fischel, *supra* note 4, at 149-50; *infra* notes 32-34 and accompanying text.

6. *See, e.g.*, Gordon, *supra* note 4, at 1589. Professor Jeffrey Gordon states:

> If performance is not simultaneous, one party will have invested greater resources in performance, or in reliance, than the other at any given time. These sunk costs, in combination with a damage measure that is not fully compensatory, give the other party the opportunity to renegotiate the contract on more favorable terms.

Id. (footnote omitted). Investment of contract-specific assets or skills is really part of the more general problem that arises when a party becomes isolated from market forces as contract performance progresses. *See* Muris, *supra* note 4, at 522-23. This isolation allows the other party to extract extra compensation as a condition of continuing to perform its obligations. A number of contract doctrines discourage this behavior, including the doctrine of consideration. *See, e.g.*, Alaska Packers' Ass'n v. Domenico, 117 F. 99 (9th Cir. 1902) (holding a contract modification demanded by sailors in mid-voyage unenforceable for lack of consideration); R. POSNER, ECONOMIC ANALYSIS OF LAW 87 (3d ed. 1986).

other side after performance has begun.[7]

This scholarly interest in postcontractual opportunism has not extended to the precontractual stage of business dealings.[8] Law and economics scholars have assumed that parties in the precontractual stage are not likely to invest heavily in contract-specific assets and that the costs of finding suitable substitutes for performance are relatively low.[9] More traditional doctrinal scholars likewise have failed to explore the concept of opportunism in their analyses of precontractual legal regulation.[10] Both groups' approaches reflect traditional doctrinal distinctions, which sharply differentiate between precontractual and postcontractual dealings.[11]

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7. *See, e.g.*, Butler & Baysinger, *supra* note 4, at 1016 (describing the example of an attorney who gained specialized knowledge of a client's case and used the knowledge as leverage to renegotiate the fee); Williamson, Wachter & Harris, *Understanding the Employment Relation: The Analysis of Idiosyncratic Exchange*, 6 BELL J. ECON. 250, 250 (1975) (discussing the market for employees in which on-the-job training is crucial).

8. In theory, economists view opportunism as a pervasive phenomenon that can arise "during original negotiations, during contract execution, and at contract renewal stages. Strategic behavior is involved in all cases." Williamson, Wachter & Harris, *supra* note 7, at 259. Precontractual opportunism, however, has been discounted in favor of postcontractual opportunism in which parties have invested in contract-specific assets or skills. *See, e.g.*, Lorenz, *Neither Friends nor Strangers: Informal Networks of Subcontracting in French Industry*, in TRUST: MAKING AND BREAKING COOPERATIVE RELATIONS 198 (D. Gambetta ed. 1988) [hereinafter COOPERATIVE RELATIONS] (suggesting that opportunism is "obvious enough in the case of contract enforcement, but perhaps less so in those of negotiation and adaptation"); *see also* Butler & Baysinger, *supra* note 4, at 1015-16 (asserting that opportunism occurs because of "postcontractual manipulation of the terms of trade"); Goetz & Scott, *The Mitigation Principle: Toward a General Theory of Contractual Obligation*, 69 VA. L. REV. 967, 982-83 (1983) (arguing that opportunistic behavior affects "renegotiation more than original negotiations"); Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents, and the Competitive Contracting Process*, 21 J.L. & ECON. 297, 297 (1978) (discussing the problem of "postcontractual opportunistic behavior"); Muris, *supra* note 4, at 523.

9. *See, e.g.*, Goetz & Scott, *supra* note 8, at 972 (asserting that "where a developed market for substitute performance exists, the potential for opportunism is negligible"); Muris, *supra* note 4, at 523-24 (finding that if another performing party "were available post contract, . . . credibly no incentive for opportunism would exist"); Narasimhan, *Relationship or Boundary*, *supra* note 4, at 1081-82 (arguing that precontractual opportunism based on relational factors is "likely to be infrequent, especially in business settings," and opportunism based on information asymmetries is controlled adequately through implied warranties and legal doctrines that require accurate information disclosures).

10. *See, e.g.*, Barnett & Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentations*, 15 HOFSTRA L. REV. 443 (1987); Farnsworth, *Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations*, 87 COLUM. L. REV. 217 (1987); Feinman, *Promissory Estoppel and Judicial Method*, 97 HARV. L. REV. 678 (1984); Gergen, *Liability for Mistake in Contract Formation*, 64 S. CAL. L. REV. 1 (1990); Metzger & Phillips, *The Emergence of Promissory Estoppel As an Independent Theory of Recovery*, 35 RUTGERS L. REV. 472 (1983).

11. Both the common law, *see* RESTATEMENT (SECOND) OF CONTRACTS § 205 (1981), and the Uniform Commercial Code, *see* U.C.C. § 1-203 (1987), impose a general duty of "good faith" in the performance and enforcement of contracts. Both sources, however, disclaim any good faith duty during the negotiation of agreements. *See* RESTATEMENT (SECOND) OF CONTRACTS § 205 comment c (stating that "[b]ad faith in negotiation" is not within the scope of the section dealing with the

This Article challenges the assumptions of law and economics scholars regarding precontractual opportunism and seeks to fill a significant gap in the doctrinal analysis of commercial negotiation. First, the Article argues that the dangers of opportunism arise in the precontractual stages of business relations more frequently than law and economics literature has recognized.[12] Opportunism often is more subtle in initial negotiations than in long-term contracts, and precontractual losses usually are more modest than those in the postcontractual cases. Nevertheless, a case survey reveals recurring fact patterns that point strongly toward the presence of opportunism in the initial negotiation of agreements.

Second, as a normative matter, the Article posits that legal doctrines regulating the precontractual stage can be made more precise and effective by directly introducing the concept of opportunism into the law. Third, the Article argnes that regulation of precontractual opportunism is appropriate because opportunistic behavior during bargaining undermines one of the fundamental psychological conditions for the successful coordination of complex commercial transactions—interpersonal trust.[13] Social psychologists,[14] sociolo-

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duty of good faith in performance and enforcement of contracts); U.C.C. § 1-203. The Seventh Circuit recently stated:

> In a business transaction both sides presumably try to get the best of the deal. That is the essence of bargaining and the free market. . . . [N]o legal rule bounds the run of business interest. So one cannot characterize self-interest as bad faith. No particular demand in negotiations could be termed dishonest, even if it seemed outrageous to the other party. The proper recourse is to walk away from the bargaining table, not to sue for "bad faith" in negotiations.

Feldman v. Allegheny Int'l, Inc., 850 F.2d 1217, 1223 (7th Cir. 1988).

German and Japanese law take a contrary view and impose a general obligation of good faith in the formation of contracts. *See* Z. KITAGAWA, DOING BUSINESS IN JAPAN § 1.03[3][b] (1989) (equating the Japanese law concept of "keiyaki teiketsu-jo no kashitsu" to the German law concept of "culpa in contrahendo," or fault in contracting); Kessler & Fine, *Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964) (discussing "culpa in contrahendo"); *see also* A. VON MEHREN & J. GORDLEY, THE CIVIL LAW SYSTEM 837-40 (2d ed. 1977); Farnsworth, *supra* note 10, at 239-41 & n.84 (discussing the law of bargaining in good faith in Germany, Japan, Argentina, Israel, Italy, and Yugoslavia).

12. *See infra* notes 60-133 and accompanying text.

13. Lorenz, *supra* note 8, at 201 (suggesting that "the problem of trust in economic exchange is raised by the potential for opportunism inherent in investment in specific assets").

14. *See, e.g.*, M. DEUTSCH, THE RESOLUTION OF CONFLICT 143 (1973) (arguing that "learned men throughout the ages" have disagreed about whether to trust or not, but they agree about the importance of the subject); D. PRUITT, NEGOTIATION BEHAVIOR 92, 100 (1981) (stating that "trust encourages coordinative behavior by reducing the danger of [loss]" from high-risk bargaining behavior, and "even low-risk forms require some degree of trust"); Golembiewski & McConkie, *The Centrality of Interpersonal Trust in Group Processes*, in THEORIES OF GROUP PROCESSES 131 (C. Cooper ed. 1975) (stating that "[p]erhaps there is no single variable which so thoroughly influences interpersonal and group behavior"). Marketing scholars also have identified interpersonal trust as the key to successful commercial dealings. *See, e.g.*, Dwyer, Schurr & Oh, *Developing Buyer-Seller*

gists,[15] economists,[16] philosophers,[17] and legal scholars[18] all have recognized that trust is central to the efficient coordination of human goals. Once trust is established, commercial parties are better able to take risks that are necessary to coordinate transactions.[19] Without trust, parties must resort to costly mechanisms such as simultaneous exchanges, precontractual contracts, or deposits to reduce suspicion of one another's motives to manageable levels.[20] If these mechanisms are unavailable, parties may forego transactions altogether.

Relationships, 51 J. MARKETING 11, 18 (1987) (discussing the importance of trust in the "exploration" phase of commercial relationships as a device to understand "expectations for cooperation and planning in a relational contract"); Hawes, Mast & Swan, *Trust Earning Perceptions of Sellers and Buyers*, 9 J. PERS. SELLING & SALES MGMT. 1, 1 (1989) (asserting that "[t]rust is the binding force in most productive buyer/seller relationships"); Schurr & Ozanne, *Influences on Exchange Processes: Buyers' Preconceptions of a Seller's Trustworthiness and Bargaining Toughness*, 11 J. CONSUMER RES. 939, 939 (1985) (writing that "theories of dyadic behavior have long held that trust is an essential ingredient in cooperation and agreement").

15. *See, e.g.*, B. BARBER, THE LOGIC AND LIMITS OF TRUST 166 (1983) (noting that trust is "one essential source of social order"); N. LUHMANN, TRUST AND POWER (1973); Zucker, *Production of Trust: Institutional Sources of Economic Structure, 1840-1920*, 8 RES. ORGANIZATIONAL BEHAV. 53, 56 (1986) (asserting that "[t]rust has been acknowledged in economic and organization theory as the most efficient mechanism for governing transactions, and in sociology as 'essential for stable social relationships,' vital for maintenance of cooperation in society, or necessary as grounds for even the most routine, everyday interaction").

16. *See, e.g.*, R. FRANK, PASSIONS WITHIN REASON x (1988) (observing the importance of trust in commercial ventures); R. POSNER, *supra* note 6, at 238-39 (noting that "trustworthiness" reduces "costs of transactions"); Arrow, *Gifts and Exchanges*, in ALTRUISM, MORALITY AND ECONOMIC THEORY 24 (E. Phelps ed. 1975) [hereinafter ALTRUISM, MORALITY AND ECONOMIC THEORY] (stating that "[v]irtually every commercial transaction has within itself an element of trust"); McKean, *Economics of Trust, Altruism, and Corporate Responsibility*, in ALTRUISM, MORALITY AND ECONOMIC THEORY, *supra*, at 29 (positing that greater ability to trust "would save many costs").

17. *See, e.g.*, Baier, *Trust and Antitrust*, 96 ETHICS 231, 232 (1986) (stating that "any form of cooperative activity, including the division of labor, requires the cooperators to trust one another to do their bit, or at the very least to trust the overseer with his whip to do his bit, where coercion is relied on"); Bok, *Can Lawyers Be Trusted?*, 138 U. PA. L. REV. 913, 920 (1990) (remarking on the "minimum of trust that is the prime constituent of the social atmosphere in which all human interaction takes place" and stating that "too high a level of distrust stifles efforts at cooperation as much as severe pollution impairs health").

18. *See, e.g.*, Farber & Matheson, *Beyond Promissory Estoppel: Contract Law and the "Invisible Handshake,"* 52 U. CHI. L. REV. 903, 905-06 (1985) (arguing that trust is a "moral value" and that exceptions to the doctrine of consideration are all based on legal policy of protecting "the ability of individuals to trust promises in circumstances in which that trust is socially beneficial"); Heymann, *The Problem of Coordination: Bargaining and Rules*, 86 HARV. L. REV. 797, 821-23 (1973) (discussing "the problem of trust" in connection with social coordination); Macneil, *Values in Contract: Internal and External*, 78 NW. U.L. REV. 340, 348-49 (1983) (speaking of "solidarity" as a basic trait in human nature that enables humans to resolve the contradiction of being both selfish and unselfish at the same time and defining solidarity as "a helief in being able to depend on another").

19. *See* D. PRUITT, *supra* note 14, at 100-01 (asserting that trust permits parties to take high-risk coordinative behaviors, such as large concessions, proposals for compromise, unilateral tension-reduction steps, and candid disclosures of motive and priority); *infra* notes 152-56, 183-85 and accompanying text.

20. *See infra* notes 146-47 and accompanying text.

Until now, scholarship regarding the relationship between law and trust has been lacking. Legal economists have discounted trust in their analyses of legal regulation.[21] At the opposite extreme, more traditional scholars have treated trust as a self-evident necessity of commercial dealings without examining the social psychological mechanisms for creating and maintaining trust. This Article addresses the shortcomings of both law and economics theorists and traditional scholars. It does so by exploring theoretical and empirical research on trust from the fields of sociology and social psychology and linking that research to the judicially imposed legal penalties for precontractual opportunism.

Part II of this Article first discusses and defines commercial opportunism. Part II then describes the landscape of complex commercial negotiations. By exploring the wide variety of doctrines that courts have manipulated to compensate victims of precontractual opportunistic conduct, this section demonstrates that transaction-specific investments are common in complex negotiations. Part III explores why precontractual opportunism is socially and economically undesirable. Part III examines sociological and social psychological literature on the dynamics of interpersonal trust and asserts that precontractual transaction-specific investments are part of a vital trust-building process that undergirds many commercial relationships. Part IV looks at the role of law in supporting the construction of trusting commercial relationships. After analyzing nonlegal methods of deterring opportunistic conduct and reviewing the costs of legal intervention, Part IV concludes that legal rules proscribing opportunism in negotiation are justified as a means to reinforce and support the process of building trust. Part IV then extends this analysis by suggesting a new cause of action to improve deterrence of precontractual opportunistic conduct. Part V concludes with a summary and a suggestion for further research.

21. Law and economics literature is rich with articles on the role of law, particularly contract law, in promoting commercial cooperation. None of these articles, however, explores the possibilities of cooperation based on trust and tbe role of law in promoting trusting relationships. A leading legal economist, Professor Robert Scott, recently suggested why trust is ignored. He argued:

> [Commercial parties] behave under two sets of rules: a strict set of rules for legal enforcement and a more flexible set of rules for social enforcement. It may be that the great lesson for the courts is that any effort to judicialize these social rules will destroy the very informality that makes tbem so effective in the first instance.

Scott, *A Relational Theory of Default Rules for Commercial Contracts*, 19 J. LEGAL STUD. 597, 615 (1990). Trust may be a psychological phenomenon that legal economists feel is best left to Scott's realm of "social enforcement." *Id.*

II. Legal Regulation of Opportunism in Commercial Negotiations

A. *Opportunism and Transaction-Specific Investments*

The term "opportunism" is not defined precisely in either the legal or economic literature. As commonly used, however, the term carries negative connotations, describing instances in which someone reneges on an agreement or understanding to take advantage of a new opportunity.[22] According to Professor Timothy Muris, commercial opportunism arises when a performing party "behaves contrary to the other party's understanding of their contract, but not necessarily contrary to the agreement's explicit terms, leading to a transfer of wealth from the other party to the performer."[23]

Economist Oliver Williamson defines opportunism more broadly as "self-interest seeking with guile."[24] Williamson emphasizes that opportunism is rooted in situations in which parties have asymmetric information. He focuses on commercial exploitation that is based on "selective or distorted information disclosure or . . . self-disbelieved promises regarding future conduct."[25] According to Professor Williamson's broader definition, opportunism is a pervasive problem in business dealings because parties almost always have different or unequal amounts of information regarding facts, intentions, or interpretations related to transactions.[26]

This Article is concerned with a more narrowly framed form of opportunism than that presented by either Muris or Williamson. The Article focuses on precontractual bargaining situations in which parties have invested transaction-specific resources. A branch of institutional

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22. The term "opportunism" often is used to describe the behavior of politicians who alter their positions when shifting political winds make adherence to previously announced principles unpopular or inconvenient. *See* Shorter Oxford English Dictionary 1454 (3d ed. 1973) (defining opportunism as: "In politics, the policy of doing what is presently expedient, as opposed to rigid adherence to party principles").

23. Muris, *supra* note 4, at 521; *see also* Butler & Baysinger, *supra* note 4, at 1015-16 (arguing that "opportunism occurs when one party to a transaction recognizes that the other transactor cannot economically retaliate against postcontractual manipulation of the terms of trade, and then engages in such manipulation in order to effect an unexpected transfer of wealth from the other transactor").

24. O. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications 26 (1975).

25. Williamson, Wachter & Harris, *supra* note 7, at 259. Williamson recently has elaborated on this definition. He now writes that "opportunism refers to the incomplete or distorted disclosure of information, especially to calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse." O. Williamson, The Economic Institutions of Capitalism 47 (1985).

26. No commentator has yet undertaken a comprehensive study of the legal regulation of "guile," in Williamson's broad sense. Similarly, this project is well beyond the scope of the present inquiry. Those questioning the pervasiveness of guile in human affairs need only consult the story of the Garden of Eden, in which the serpent convinced Eve that it had superior information regarding the fruit of the knowledge of good and evil. *Genesis* 3:5 (King James).

theory known as "transaction cost economics" helps to identify this fact pattern as particularly likely to create opportunism problems.[27]

Transaction cost economics is essentially the study of the legal and nonlegal mechanisms[28] used by parties to reduce the costs of negotiating, monitoring, and performing mutually beneficial agreements.[29] Transaction cost theory makes two basic assumptions about human behavior. First, human beings have "bounded rationality"—less than perfect information about their contracting partners and future events. Thus, they are incapable of knowing, understanding, or providing for all possible contingencies in their relationships.[30] Second, some people are opportunistic and, if the chance arises, will serve their self-interests at the expense of their contracting partners.[31]

Transaction cost economics adds to these assumptions the hypothesis that asset specificity is the most vital indicator for describing transactions.[32] Given the assumption of bounded rationality, the danger of opportunism will be most acute and noticeable when the transaction is accompanied by investments in assets that are specifically tailored to the transaction and cannot fully be salvaged outside the transaction.[33]

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27. Williamson introduced the theory of transaction cost economics. For a full description of this theory, see O. WILLIAMSON, *supra* note 25, at 15-42.

28. Williamson's work on transaction cost economics has emphasized nonlegal contractual governance mechanisms. *Id.* at 29 (stating that property rights and mechanism-design literature "work within the tradition of legal centralism," and "transaction cost economics disputes that court ordering is efficacious"). Contract law scholars also have used a transaction cost approach to explain why contract law doctrines sometimes reduce the transaction costs of contracting within a legal system. *See, e.g.*, A. KRONMAN & R. POSNER, THE ECONOMICS OF CONTRACT LAW 4 (1979); Goetz & Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 YALE L.J. 1261 (1980).

29. Williamson has explained that transaction costs "are the economic equivalent of friction in physical systems." O. WILLIAMSON, *supra* note 25, at 19. In a contractual relationship, examples of friction include negotiating and communicating about an agreement, monitoring performance, dealing with unexpected contingencies, and enforcing the contract if the agreement breaks down before performance is complete. Some friction is inherent in the contracting process, but all parties to an agreement benefit to the extent that these costs can be reduced. Legal philosophers critical of economic approaches to the law have stated that "[n]o term in the philosopher's lexicon is more imprecisely defined than is the economist's term 'transaction costs.' Almost anything counts as a transaction cost." J. MURPHY & J. COLEMAN, PHILOSOPHY OF LAW 217 (1990).

30. O. WILLIAMSON, *supra* note 25, at 44-47; Shell, *Arbitration and Corporate Governance*, 67 N.C.L. REV. 517, 566-67 (1989). Many economic models assume for purposes of analysis that parties have perfect information regarding themselves, each other, and the world in which they operate. *See, e.g.*, Coase, *The Problem of Social Cost*, 3 J.L. & ECON. 1 (1960). In contrast, transaction cost economics makes no such assumption.

31. The term "opportunism" is used here in its broadest sense of "self-interest seeking with guile." *See supra* note 24 and accompanying text. Transaction cost theory does not require that parties always act opportunistically. It is enough that some people are inclined to act opportunistically and that it is difficult for nonopportunists to identify the opportunists in advance. O. WILLIAMSON, *supra* note 25, at 64-67.

32. O. WILLIAMSON, *supra* note 25, at 30.

33. *Id.* at 53 (noting that "[t]ransactions that are supported by investments in durable,

Thus, although opportunism is a danger whenever parties possess asymmetric information, it becomes more likely when one side has taken affirmative, costly steps or has foregone unique alternatives which expose that side to exploitation by the other side. Judge Richard Posner has given the following example to illustrate the danger of opportunism when specialized assets are the subject of a commercial transaction:

> If A contracts to build a highly idiosyncratic gazebo for B, payment due on completion, and when A completes the gazebo B refuses to pay, A may be in a bind—since the resale value of the gazebo may be much less than A's cost—except for his right to sue B for the price. Even then, a right to sue for breach of contract, being costly to enforce, is not a completely adequate remedy. B might therefore go to A and say, "If you don't reduce your price I'll refuse to pay and put you to the expense of suit"; and A might knuckle under.[34]

Transaction cost economics uses the concepts of asset specificity and the resulting danger of opportunism to predict the form business enterprises will take. In transactions marked by idiosyncratic assets and an acute danger of opportunism, firms will forego bargaining in markets altogether and completely internalize transactions by vertical integration, particularly when the type of exchange is likely to recur.[35] As the dimension of asset specificity changes, various forms of integrated commercial exchange emerge, ranging from joint ventures and franchise relations to complex contracting for construction projects and conventional market transactions for nonspecialized, one-shot deals.[36]

The concepts of asset specificity and opportunism also have implications for the study of the legal regulation of contractual relations. As

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transaction-specific assets experience 'lock-in' effects, on which account autonomous trading will commonly be supplanted by unified ownership (vertical integration)"). Williamson has written:

> The crucial investment distinction is this: to what degree are transaction-specific (nonmarketable) expenses incurred. Items that are unspecialized among users pose few hazards, since buyers in these circumstances can easily turn to alternative sources, and suppliers can sell output intended for one order to other buyers without difficulty. Nonmarketability problems arise when the *specific identity* of the parties has important cost-bearing consequences. Transactions of this kind will be referred to as idiosyncratic.

Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & Econ. 233, 239-40 (1979) (footnote omitted).

34. Wisconsin Knife Works v. National Metal Crafters, 781 F.2d 1280, 1285 (7th Cir. 1986) (Posner, J.). The assets in question need not be durable. Rather, they can take the form of human knowledge. *See supra* note 7. Ordinary skills also can become highly specialized if the market for replacements is remote. In Alaska Packers Ass'n v. Domenico, 117 F. 99 (9th Cir. 1902), for example, the defendant hired sailors in San Francisco to set up a fishing cannery in Alaska. Once the ship had reached its remote port in Alaska, the sailors announced that they would not work unless their wages were raised. Having no good alternatives, the defendant acquiesced to the demand. *Id.* at 101. Later, the defendant reneged and refused to pay the new wages. The sailors sued, but the court refused to enforce the revised contract on the grounds that it lacked consideration. *Id.* at 102.

35. O. Williamson, *supra* note 25, at 82-105, 240-72.

36. *See* Williamson, *supra* noto 33, at 247-53.

indicated earlier,[37] legal scholars have utilized these concepts in analyzing a number of problems that arise once commercial parties have established a contractual relationship and performance is underway. For example, several studies have explored the problem identified above by Judge Posner: how should the law treat attempts to renegotiate the terms of an agreement in mid-performance after contract-specific investments are in place?[38] Professor Subha Narasimhan recently has expanded this analysis to situations dealing with successive discrete contracts between the same parties.[39] Still others have investigated opportunistic incentives that arise in ongoing contractual settings such as franchising relationships,[40] employment relations,[41] and public corporations.[42]

Many law and economics scholars have concluded that legal regulation of postcontractual opportunistic conduct either is unwarranted or highly problematic.[43] They argue that market incentives such as a concern for market reputation and the likelihood of repeated dealings with the same parties are adequate mechanisms to police opportunistic behavior.[44] Moreover, business parties that are concerned with specific forms of postcontractual opportunism may bargain explicitly to pro-

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37. *See supra* notes 4-7 and accompanying text.

38. *See, e.g.*, Graham & Peirce, *supra* note 4; Muris, *supra* note 4; Narasimhan, *Of Expectations, Incomplete Contracting, and the Bargain Principle*, 74 CALIF. L. REV. 1123 (1986); Narasimhan, *Modification*, *supra* note 4; Robison, *supra* note 4.

39. Narasimhan, *Relationship or Boundary*, *supra* note 4.

40. *See, e.g.*, Hadfield, *supra* note 4.

41. *See, e.g.*, Note, *supra* note 4.

42. *See, e.g.*, Gordon, *supra* note 4; Williamson, *supra* note 33.

43. *See, e.g.*, Butler & Baysinger, *supra* note 4, at 1109 (criticizing the use of antitrust laws to curb opportunism and stating that all vertical restraints should be "per se legal"); Easterbrook & Fischel, *Close Corporations and Agency Costs*, 38 STAN. L. REV. 271, 295-96 (1986) (arguing against giving minority shareholders in close corporations easy access to dissolution and mandatory buyout remedies for bad faith actions by majority shareholders); Epstein, *In Defense of the Contract at Will*, 51 U. CHI. L. REV. 947, 951 (1984) (arguing that employers should be free to terminate at-will employees unless the employment contract specifies otherwise); Fischel, *supra* note 4, at 140-46 (arguing against giving debtors claims against lenders based on broad standards of good faith); Klein, *Transaction Cost Determinants of "Unfair" Contractual Arrangements*, 70 AM. ECON. REV. 356, 359-60 (1980) (arguing that franchisors should have the power to terminate franchisees at will unless the contract otherwise provides); Scott, *Conflict and Cooperation in Long-Term Contracts*, 75 CALIF. L. REV. 2005, 2054 (1987) (advocating "traditional deference to party autonomy," rather than a general good faith standard, in constructing legal rules to govern postcontractual adjustment of commercial relations); Note, *supra* note 4, at 528-29 (agreeing that employers should be able to terminate employees at will unless the contract specifies otherwise). Dissenters include Professor Muris, who has argued that implied terms of good faith, properly understood to address opportunistic behavior, play an important role, *see* Muris, *supra* note 4, at 572, and Professor Narasimhan, who has argued for a duty of good faith negotiation in the renewal of successive contracts between the same parties under some circumstances. *See* Narasimhan, *Relationship or Boundary*, *supra* note 4, at 1117-22.

44. *See* Epstein, *supra* note 43, at 968; Fischel, *supra* note 4, at 138.

hibit opportunistic conduct in their original contract, eliminating the need for noncontractual legal protection.[45] These scholars fear that the creation of legal claims to deter opportunism may backfire and result in groundless lawsuits by parties who took known risks at the outset of a relationship, but became disappointed with the outcome of the transaction. In short, these scholars recognize the danger of opportunism, but worry that using the legal system to redress the problem could be worse than the danger itself.[46]

Law and economics scholars have not yet addressed comprehensively the danger of opportunism in the precontractual period. It seems clear, however, that their suspicion of postcontractual legal intervention would make them leery of legal supervision of the bargaining process. More important, most treatments of postcontractual opportunism have suggested that asset specificity does not reach legally important levels in the precontractual stage of business relations.[47] The remainder of this Part endeavors to prove this assumption incorrect.

B. *Negotiation and Opportunism*

1. Negotiation: A Complex, Multistage Process that Develops Business Relationships

Legal doctrines governing contract formation convey a mechanical, assured image of the negotiation process. Traditional contract law views negotiation as an orderly procedure consisting of an exchange of offers and counter-offers followed by an acceptance or rejection. The principle questions addressed by these doctrines are whether and when a contract has been formed.[48] This focus on the exchange of discrete expressions of intent leads to legal preoccupation with such "tantalizing

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45. Easterbrook & Fischel, *supra* note 43, at 287, 293.

46. *See id.* at 287; Epstein, *supra* note 43, at 975-76; Fischel, *supra* note 4, at 140-41.

47. *See supra* note 9 and accompanying text. Professors Robert Scott and Charles Goetz have argued that it is desirable for negotiators to take responsibility for their own costs, including the costs of premature reliance. *See* Goetz & Scott, *supra* note 28, at 1293-96. They argue that bargaining to protect parties from liability for precontractual reliance is more costly than bargaining for a contract to assure that reliance will be compensated. *Id.* Professor Scott has argued elsewhere that parties would rather risk uncompensated reliance losses than liability for another person's reliance because parties can exercise more control over their own reliance expenditures. *See* R. SCOTT & D. LESLIE, CONTRACT LAW AND THEORY 137 (1988). These analyses ignore the possibility that reliance may have significance to the developing relationship between the parties precisely because it is both costly and unprotected by conventional contract. *See* Charny, *Nonlegal Sanctions in Commercial Relationships*, 104 HARV. L. REV. 375, 378, 429-41, 446-56 (1990) (analyzing legal compensation for precontractual reliance in terms of information and drafting costs); *id.* at 379 (concluding that "[l]egal decisionmakers should intervene sparingly, only when the parties' assessment [of the availablility and effectiveness of nonlegal sanctions] was significantly mistaken").

48. E. FARNSWORTH, CONTRACTS §§ 3.1-3.2, at 106-08 (1982).

puzzles" as the battle of the forms and the mailbox rule.[49] The result is legal scholarship that emphasizes situations in which parties engage in essentially zero-sum, single-issue "positional bargaining."[50]

Many social scientists[51] and a growing number of legal scholars[52] view the contract formation process more realistically. Negotiation, far from being a clock-like mechanism, is seen as a complex commercial institution that marks the preliminary stage in all business relations.[53] The typical negotiation process is not a positional tug of war over a single issue. Instead, negotiation concerns the development of human relationships, takes considerable time, involves multiple issues, and often includes many parties.[54] On close examination, even a relatively

49. Farnsworth, *supra* note 10, at 218.

50. *See, e.g.*, Norton, *Bargaining and the Ethic of Process*, 64 N.Y.U. L. REV. 493, 494 n.1 (1989) (stating that "[n]egotiation often involves the use of a mixture of strategies, but because most use some version of offers and counteroffers, positional bargaining is the paradigm for this Article"). A number of articles have addressed the particular problems faced by lawyers as negotiaters and have puzzled over the problem of lying and deception in routine, essentially zero-sum bargaining encounters. *See, e.g.*, Guernsey, *Truthfulness in Negotiation*, 17 U. RICH. L. REV. 99 (1982); Peters, *The Use of Lies in Negotiation*, 48 OHIO ST. L.J. 1 (1987); Thurman, *Chipping Away at Lawyer Veracity: The ABA's Turn Toward Situation Ethics in Negotiations*, 1990 J. DISPUTE RESOLUTION 103; White, *Machiavelli and the Bar: Ethical Limitations on Lying in Negotiation*, AM. BAR FOUND. RES. J. 926 (1980).

51. Social psychologists and other social scientists have studied complex bargaining in great detail. *See, e.g.*, P. GULLIVER, DISPUTES AND NEGOTIATIONS: A CROSS-CULTURAL PERSPECTIVE (1979); R. LEWICKI & L. LITTERER, NEGOTIATION (1985); D. PRUITT, *supra* note 14; A. ROTH, GAME-THEORETIC MODELS OF BARGAINING (1985); J. RUBIN & B. BROWN, THE SOCIAL PSYCHOLOGY OF BARGAINING AND NEGOTIATION (1975); A. STRAUSS, NEGOTIATIONS (1978); R. WALTON & R. MCKERSIE, A BEHAVIORAL THEORY OF LABOR NEGOTIATIONS (1965); I. ZARTMAN & M. BERMAN, THE PRACTICAL NEGOTIATOR (1982).

52. *See, e.g.*, Eisenberg, *Private Ordering Through Negotiation: Dispute-Settlement and Rulemaking*, 89 HARV. L. REV. 637 (1976); Farnsworth, *supra* note 10; Gifford, *A Context-Based Theory of Strategy Selection in Legal Negotiation*, 46 OHIO ST. L.J. 41 (1985); Heymann, *supra* note 18; Lowenthal, *A General Theory of Negotiation Process, Strategy and Behavior*, 31 U. KAN. L. REV. 69 (1982); Menkel-Meadow, *Toward Another View of Legal Negotiation: The Structure of Problem-Solving*, 31 UCLA L. REV. 754 (1984); Stulberg, *Negotiation Concepts and Advocacy Skills: The ADR Challenge*, 48 ALB. L. REV. 719 (1984).

53. J. COMMONS, THE ECONOMICS OF COLLECTIVE ACTION 126 (1970) (asserting that "[a]ll economic activity goes through three stages—negotiation, transaction, and administration"); Ring & Van de Ven, *Formal and Informal Dimensions of Transactions*, in RESEARCH ON THE MANAGEMENT OF INNOVATION: THE MINNESOTA STUDIES 173-74 (A. Van de Ven, H. Angles & M. Poole eds. 1989).

54. As one leading commentator has noted:

> Ours is an era of "deals"—for the long-term supply of energy, for the development of a shopping center, for the friendly takeover of a corporation, for the signing of a first-round draft choice. . . . The terms [of such deals] are reached by negotiations, usually face-to-face over a considerable period of time and often involving corporate officers, bankers, engineers, accountants, lawyers, and others. . . . During the negotiation of such deals there is often no offer or counter-offer for either party to accept, but rather a gradual process in which agreements are reached piecemeal in several "rounds" with a succession of drafts. There may first be an exchange of information and an identification of the parties' interests and differences, then a series of compromises with tentative agreement on major points, and finally a refining of contract terms.

simple negotiation, such as a consumer's new car purchase, turns out to be an elaborate interaction concerning many issues that can make an agreement difficult to reach.[55]

Anthropologist P.H. Gulliver's general description of negotiation in his classic cross-cultural study[56] confirms this revisionist characterization of commercial negotiation. According to Gulliver, the negotiation process typically is an extended interaction in which people:

> accumulate an experience of each other and of the changing situation in which they are operating and interacting. They develop an appreciation (not necessarily objectively accurate, of course) of each other, of themselves, and of the apparent potentialities and impossibilities between them. There is likely to be some development of their immediate relationship as negotiators in terms of . . . competitiveness or cooperation, trust or mistrust, cautiousness or candor, respect or disdain.[57]

Business negotiations are no exception to this pattern. Commercial bargaining encounters are multistage processes in which business people test and learn about each other as well as the issues under consideration.[58] When skillfully executed, the bargaining exchange enables the parties to benefit from their experience with each other and helps them to achieve satisfaction with a particular outcome.[59]

Farnsworth, *supra* note 10, at 218-19. Indeed, there even appears to be a distinct "prenegotiation" phase to complex transactions in which the parties discuss whether and how they will negotiate. *See, e.g., Occidental Petroleum Corp.*, Wall St. J., July 13, 1990, at B2, col. 6 (reporting that "Occidental Petroleum said that its Occidental Chemical Corp. unit has held discussions on the [possible acquisition of European Vinyls Corp.] but that these talks haven't reached the level of negotiations"). Economists have termed this prenegotiation process the "cheap talk" phase. *See, e.g.*, Crawford & Sobel, *Strategic Information Transmission*, 50 ECONOMETRICA 1431 (1982); Farrell & Gibbons, *Cheap Talk Can Matter in Bargaining*, 48 J. ECON. THEORY 221 (1989).

55. *See, e.g., How to Drive a Hard Bargain in a Soft Market*, CONSUMER REP. 213 (1990). The article reports tbat "[n]ew car sales are down and aggressive advertising is up. But sluggish auto sales don't necessarily make it easier to negotiate a good deal on a new car. In fact, rebates, low-interest financing, and other incentives can create considerable confusion about the actual price." *Id.*

56. P. GULLIVER, *supra* note 51.

57. *Id.* at 73. In studying negotiation, Gulliver found that a common pattern emerged to accomplish these complex goals. Negotiation consists of eight distinct stages: (1) the search for a negotiating arena; (2) the formulation of an agenda; (3) preliminary exchanges of information, positions, and interests; (4) narrowing and selection of primary issues, including occasional tentative agreements on secondary issues; (5) preparation for final bargaining; (6) final bargaining; (7) ritual confirmation of the final terms of the agreement; and (8) implementation. *Id.* at 82. Gulliver did not maintain that each stage was present in every negotiation. He also acknowledged that certain stages might be combined or taken out of order. *Id.*

58. *See* Hamner, *Effects of Bargaining Strategy and Pressure to Reach Agreement in a Stalemated Negotiation*, 30 J. PERSONALITY & SOC. PSYCHOLOGY 458, 465 (1974). The article notes that "negotiators expect something more than just a mutually rewarding payoff. They also seem to expect a rewarding social exchange, trial by trial." *Id.*

59. P. GULLIVER, *supra* note 51, at 177. Courts sometimes recognize that parties form relationships based on bargaining interactions and that these relationships change as negotiations progress. *See, e.g.*, Opdyke Inv. Co. v. Norris Grain Co., 413 Mich. 354, 320 N.W.2d 836 (1982) (holding that an agreement to agree in the second letter of intent might be binding because the

2. Investment of Transaction-Specific Resources During Negotiation

If one contemplates negotiation as a time-consuming exchange in which people test their relationship at the same time they discuss their deal, the possibility emerges that parties might commit resources to a proposed transaction before forming a contract under traditional contract law. In essence, parties use the negotiation process to express who they are—or who they want the other side to *think* they are—and to learn about the other side's disposition and character.[60] The bargaining process will reflect each side's "style,"[61] expectations about general norms of business conduct, and views about how transactions are executed most effectively. If the deal contemplates further interaction between the parties in the postcontractual period, parties may seek to portray in their bargaining behavior the type of long-term, cooperative relationship they seek in the postcontractual period.

In a world in which bargainers seek information about each other as well as the specific terms of a deal, the commitment of transaction-specific resources before contract formation may illuminate the investor's character and the type of commercial relationship being sought. Like transaction-specific investments made in the postcontractual period, however, precontractual investments expose the investor to opportunistic exploitation by the other side.[62]

Case law confirms both the range of precontractual investments that commercial parties actually make and the judicial concern over the exploitation of these investments. Indeed, the very range of judicial tools employed to remedy what is essentially one recurring fact pattern illustrates judicial sensitivity to bargaining opportunism.[63]

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parties no longer were strangers and were working toward a common goal).

60. Even if the deal is a discrete event, the precontractual bargaining is part of a personal behavioral continuum for both parties. Economist Robert Frank has argued that some people strive for consistency in their economic behavior, even in situations that promise no ongoing relationship. *See* R. FRANK, *supra* note 16, at 18. He gives the example of people tipping in restaurants in cities far from their homes. Frank explains that this behavior is a form of emotional commitment to fairness and good faith that makes it easier for people to communicate these traits credibly to other people in situations in which repeat dealings are likely. *Id.* at 16-19.

61. Professor Gerald Williams has conducted empirical research into personal negotiation styles. He has concluded that, at least among his sample of lawyer-negotiators, a majority of negotiators exhibited a "cooperative" as opposed to a "competitive" style. G. WILLIAMS, LEGAL NEGOTIATION AND SETTLEMENT 15-46 (1983). The cooperative approach was characterized by ethical principles of dealing and a commitment to fairness. *Id.* at 20.

62. Indeed, some business commentators define negotiation in terms of the danger of opportunistic exploitation. *See* D. LAX & J. SEBENIUS, THE MANAGER AS NEGOTIATOR 11 (1986) (defining negotiation as "a process of potentially opportunistic interaction in which two or more parties, with some apparent conflict, seek to do better through jointly decided action than they could do otherwise").

63. I am indebted to Professor Allan Farnsworth for his comprehensive doctrinal article on precontractual liability for many of the cases discussed in this Part. *See* Farnsworth, *supra* note

a. Precontractual Disclosure of Proprietary Information

One way in which parties make transaction-specific investments during the bargaining process is through the disclosure of valuable proprietary information. When the parties are bargaining precisely over the value of proprietary information, the owner of the information is under pressure to disclose it. By acquiescing, however, the disclosing party risks exploitation. The other side may act opportunistically, taking what it needs from the information and refusing to conclude the transaction.

The most obvious cure for the problem of precontractual disclosure of proprietary information is contract law. Sellers may require buyers to sign an express precontractual agreement to keep the information secret. This solution, however, sometimes is unsatisfactory in practice. Time constraints, mutual preferences for low preliminary bargaining costs, and pressures arising from a buyer's market may prevent sellers from demanding a precontractual confidentiality agreement.[64] In addition, some sellers, particularly amateur inventors, do not enter the market frequently. Thus, they are unsophisticated in the business world.[65]

In the absence of an express contract protecting disclosure, parties must rely on an action in tort for misappropriation of trade secrets. In applying the doctrine of misappropriation, courts have revealed their underlying concern for opportunistic bargaining. In many jurisdictions, one of the core allegations of a misappropriation claim is that the disclosure occurred within the context of a "confidential relationship."[66]

10, at 221-43. The range of doctrinal tools used by courts to deter bargaining misbehavior has been commented on by other scholars as well. *See* Gergen, *supra* note 10, at 1-4; Levmore, *Strategic Delays and Fiduciary Duties*, 74 VA. L. REV. 863, 905 n.123 (1988).

64. One situation that routinely calls for precontractual disclosure of proprietary information is the purchase and sale of a small business. Because a buyer's market now exists, *see* Selz & Robichaux, *Small Firms, Like Homes, Fetch Less*, Wall St. J., Aug. 2, 1990, at B1, col. 6, sellers may not be in a position to demand precontractual confidentiality guarantees. *See* Jefferson, *How a Failed Merger Spouted Trouble for a Faucet Firm*, Wall St. J., July 18, 1990, at B2, col. 3. The article reports on allegations by a small faucet firm that a large prospective buyer entered into merger negotiations, stole trade secrets, and then tried to drive the small firm out of business. The article states that "the courts are filled with lawsuits by entrepreneurs who allege that a potential buyer stole their secrets and roughed them up in other ways." *Id.*

65. *See, e.g.*, Smith v. Snap-On Tools Corp., 833 F.2d 578, 580 (5th Cir. 1987) (noting that the inventor was an amateur who never indicated that he intended to have a commercial relationship with the tool company); Matarese v. Moore-McCormack Lines, 158 F.2d 631, 632 (2d Cir. 1946) (remarking tbat tbe inventor was a longshoreman).

66. *See* E.I. Du Pont de Nemours Powder Co. v. Masland, 244 U.S. 100, 102 (1917) (holding that the existence of a confidential relationship is the "starting point" of the analysis in trade secrets cases); Wiesner & Cava, *Stealing Trade Secrets Ethically*, 47 MD. L. REV. 1076, 1078 (1988). A confidential relationship is required because free disclosure of trade secrets compromises their essential character as secrets. When the secret is disclosed in the context of a "confidential relationship," such as that between partners, joint venturers, or employers and employees, how-

Parties negotiating the sale of a business or proprietary information, however, often bargain at arm's length. Far from having a confidential relationship, each side is furthering its own interests. Thus, disclosure of information in this context threatens its status as a secret.[67]

Courts could apply the confidential relationship requirement strictly and rule that sellers who do not contract for protection before disclosure can obtain no relief.[68] Instead, courts have held that even an arm's length bargaining relationship becomes a relationship of confidence once the buyer accepts proprietary information from the seller in the course of negotiations. In the classic case of *Smith v. Dravo Corp.*,[69] for example, a potential buyer of a shipbuilding company requested and reviewed patent applications, blueprints, and other information regarding the seller's principal asset—the first uniform freight containers designed for use on ship and rail. After receiving this information, the buyer rejected all the seller's offers, broke off negotiations, and announced plans to design and produce its own uniform shipping container. The buyer's design differed just enough from the seller's container to avoid patent infringement.[70] In ruling for the seller on its

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ever, disclosure does not destroy the claim. Burten v. Milton Bradley Co., 763 F.2d 461, 463 (1st Cir. 1985); R. Milgrim, 1 Trade Secrets § 4.03, at 4-17 (1990). Some courts treat trade secret misappropriation as a form of conversion, viewing misappropriation simply as a wrongful taking of someone's "property." Note, *All the King's Horses—Irreparable Harm in Trade Secret Litigation*, 52 Fordham L. Rev. 804, 809-15 (1984).

67. Farnsworth, *supra* note 10, at 230 (arguing that arm's length negotiations "cannot be characterized as 'confidential' for this purpose"). Farnsworth appears to he wrong in concluding that the courts refuse to recognize arm's length negotiations as occasions for implying confidential relationships. *See infra* notes 69-73 and accompanying text. Farnsworth cites only one lower court case from California to support his conclusion. *See* Faris v. Enberg, 97 Cal. App. 3d 309, 158 Cal. Rptr. 704 (1979). In *Faris* the plaintiff was a television producer with an idea for a new game show. He revealed his idea to a prospective game show host in an effort to recruit him as an employee. The host then mentioned the idea to others. The idea itself never was negotiated between the plaintiff and defendant. The court found no evidence of an implied contract to sell the idea to anyone, much less to the game show host. *Id.* at 309, 158 Cal. Rptr. at 704. When the negotiations concern the sale of an idea, the California courts recognize an implied confidential relationship between the buyer and seller. *See* Donahue v. Ziv Television Programs, 245 Cal. App. 2d 593, 54 Cal. Rptr. 130 (1966); Thompson v. California Brewing Co., 150 Cal. App. 2d 469, 310 P.2d 436 (1957).

68. Courts have refused to find confidential relationships in arm's length bargaining encounters in the context of securities regulation. In Walton v. Morgan Stanley & Co., 623 F.2d 796 (2d Cir. 1980), the target of a friendly merger bid shared proprietary, nonpublic company information with the potential bidder's investment advisor. The advisor then used the inside information to make trades in the target's stock. The target's shareholders sued the advisor, claiming that a relationship of confidence or fiduciary duty existed between the advisor and the target company by virtue of the information disclosure. The court held that in the absence of any explicit confidentiality contract the disclosures did not create any obligation on the part of the advisor to keep the information confidential. Absent such a duty, there was no compensable "insider trading." *Id.* at 799.

69. 203 F.2d 369 (7th Cir. 1953).

70. As it turned out, the new container rendered the seller's containers "obsolete." *Id.* at 372.

claim of trade secret misappropriation, the court acknowledged that the defendant provided no express promise to keep the plaintiff's information secret[71] and that the parties were bargaining at arm's length.[72] Nevertheless, the court found a confidential relationship based on the trust that the plaintiff reposed in the buyer.[73]

The potential for implying confidential relationships in conventional bargaining exchanges has created a new avenue for opportunism in the market for inventions such as tools, gadgets, and games. Opportunistic plaintiffs have been known to flood firms buying these inventions with unsolicited, vaguely worded descriptions of new concepts, hoping that a new product eventually developed by the company will give them the basis for a misappropriation claim.[74] Many large companies protect themselves from these claims by using standard form waivers.[75] These waivers essentially state: "No confidential relationship is to be established by such submission or implied from consideration of the

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71. *Id.* at 376.

72. *Id.*

73. *Id.* Other courts similarly have held that unrelated parties bargaining at arm's length are in a confidential relationship with respect to disclosed trade secret information. *See, e.g.*, Heyman v. AR. Winarick, Inc., 325 F.2d 584, 587 (2d Cir. 1963) (holding that "whatever conduct courts should countenance when parties bargain at arm's length, we think parties should be expected to comply with these essentials of fair dealing"); Speedry Chem. Prods. v. Carter's Ink Co., 306 F.2d 328, 331-32 (2d Cir. 1962); Schreyer v. Casco Prods. Corp., 190 F.2d 921, 924 (2d Cir. 1951), *cert. denied*, 342 U.S. 913 (1952); Matarese v. Moore-McCormack Lines, 158 F.2d 631, 634 (2d Cir. 1946); Hoeltke v. C.M. Kemp Mfg. Co., 80 F.2d 912, 922-23 (4th Cir. 1935), *cert. denied*, 298 U.S. 673 (1936); Biodynamic Technologies, Inc. v. Chattanooga Corp., 644 F. Supp. 607, 611 (S.D. Fla. 1986). When it is not proven that the parties actually were engaged in negotiations, courts have been reluctant to find a confidential relationship. *See, e.g.*, *Snap-On Tools Corp.*, 833 F.2d at 580-81 (noting that ratchet inventor never explicitly asked for compensation for his invention or indicated in any way that he desired a commercial relationship with the company to which he gave the design); RTE Corp. v. Coatings, Inc., 84 Wis. 2d 105, 118, 267 N.W.2d 226, 232 (1978) (company disclosed trade secrets in context of price solicitation that did not include an offer of a contractual relationship).

74. *See Matarese*, 158 F.2d at 634. The *Matarese* court remarked:

> Courts have justly been assiduous in defeating attempts to delve into pockets of business firms through spurious claims for compensation for the use of ideas. Thus to be rejected are attempts made by telephoning or writing vague ideas to business corporations and then seizing upon some later general similarity between their products and the notions propounded as a basis for damages.

Id.

75. *See, e.g.*, *Burten*, 763 F.2d at 467 (stating, "we fully recognize that a manufacturer may wish to insulate itself from claims of misuse of materials submitted in confidence, whether founded on fact, fantasy or coincidence"); Kearns v. Ford Motor Co., 203 U.S.P.Q. (BNA) 884, 889 (E.D. Mich. 1978); Zaidan v. Borg-Warner Corp., 228 F. Supp. 669, 670-71 (E.D. Pa. 1964), *aff'd*, 341 F.2d 391 (3d Cir. 1965); Van Rensselaer v. General Motors Corp., 223 F. Supp. 323, 331 (E.D. Mich. 1962), *aff'd*, 324 F.2d 354 (6th Cir. 1963); Boop v. Ford Motor Co., 177 F. Supp. 522, 529 (S.D. Ind. 1959), *aff'd*, 278 F.2d 197 (7th Cir. 1960); Hisel v. Chrysler Corp., 94 F. Supp. 996, 1002 (W.D. Mo. 1951).

submitted material."[76] Courts have upheld the validity of these waivers to terminate the inventor's right to sue for misappropriation.[77]

Judicial recognition of confidentiality waivers, however, presents yet a third possibility for opportunism: Companies could use the waivers to steal legitimate ideas from bona fide inventors. Concern for this possibility has led courts to construe confidentiality waivers strictly.[78]

b. Commitment of Assets Toward Performance

Many commercial negotiations concern deals in which performance will be lengthy and complicated. As parties become confident of striking a final agreement, one side may begin making investments in performance. The incentives supporting precontractual commitment of assets vary, but these investments often are in the parties' mutual interests. For example, time may be of the essence in deals that require coordinated action between many parties. Second, opportunities to obtain cheap resources needed for performance may present themselves during negotiations. Third, the parties may want to test each other by coordinating a relatively minor aspect of performance before concluding the final contract. Finally, third parties may exert pressure on the negotiators to begin performance even though important terms of the contract remain open.

Investments in transaction-specific assets set the stage for opportunistic behavior by the party less committed to the deal. Blatant opportunism occurs when the less-committed party simply exploits the part performance and breaks off negotiations. Opportunism also can take subtle forms. For example, to maintain attractive options, one side might encourage precontractual performance by the other side, while

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76. Crown Indus., Inc. v. Kawneer Co., 335 F. Supp. 749, 754 (N.D. Ill. 1971).

77. *See Burten*, 763 F.2d at 464 (and cases cited therein); R. MILGRIM, *supra* note 66, § 4.03, at 4-26 (agreeing that an express disclaimer of a confidential relationship from the outset "will dispel the existence of such a relationship").

78. *See Burten*, 763 F.2d at 461. In *Burten* the waiver stated that the inventor's submission "does not, in whole or in part, establish or create by implication or otherwise any relationship between Company and me not expressed herein." *Id.* at 464 n.3. The court held that this clause was ineffective because other disclaimer clauses in the game industry explicitly mention the word "confidence" or "confidential" in contrast to Milton Bradley's broad disclaimer of "any relationship." *Id.* at 465. Moreover, viewing the contract as a whole, the court found that the parties intended something more than patent rights to survive the signing of the disclosure form. *Id.* at 465-66. The court stated:

> Massachusetts encourages the protection of trade secrets not only because the public has a manifest interest in commercial innovation and development, but because it has an interest in the maintenance of standards of commercial ethics. Fundamental to this, we believe, is the expectation by the parties that, absent an explicit waiver, the exchange of ideas will take place in trust and confidence.

Id. at 467.

engaging in undisclosed parallel negotiations or business planning activities with third parties. The performing party thus invests transaction-specific assets that expose it to possible exploitation, while the opportunistic party enhances its alternatives at little cost. Opportunists also can attempt to use the deepening commitment by the other side to practice "the nibble"—using the other side's disproportionate commitment as leverage to make one last substantial set of demands in the final stage of bargaining.[79]

The case law on precontractual commitment of performance-related resources reveals the range of doctrinal tools that the courts use to compensate victims of precontractual opportunistic behavior. The following subsections survey these doctrines.

i. Promissory Estoppel

Claims for promissory estoppel arise when one party makes a promise upon which another reasonably relies to its detriment.[80] Professors Randy Barnett and Mary Becker point out that there are two types of promissory estoppel cases: Those in which the doctrine serves as a substitute for contract law and those involving promissory misrepresentations made during negotiation.[81] This Article addresses only the promissory misrepresentation cases. The reliance element in these cases signals the existence of performance-related investments that have been exploited by the nonperforming party. Two examples illustrate how courts have used promissory estoppel to compensate victims of bargaining opportunism.

In *Skycom Corp. v. Telstar Corp.*[82] a company in the preliminary stage of negotiating the sale of all its assets disclosed information regarding one of its most valuable assets—its right to negotiate with a third party to obtain a valuable license. After signing a nonbinding letter of intent but before a final agreement was executed, the prospective

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79. Negotiation guru Herb Cohen has illustrated "the nibble" tactic by recounting a story of someone negotiating a free tie from a clothing salesperson. If the salesperson works on commission, his time is quite valuable. A customer can practice "the nibble" by trying on many different suits and generally interfering with the salesperson's ability to wait on other customers. The salesperson will become extremely committed to closing the particular sale with the customer. Then, as the salesperson is writing up the sales slip, the customer demands a free tie. The salesperson is supposedly so glad to get rid of Mr. Cohen's friend that he happily agrees. H. COHEN, YOU CAN NEGOTIATE ANYTHING 37-39 (1980). Cohen admits that he does not shop this way.

80. RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1981); E. FARNSWORTH, *supra* note 48, § 2.19; Metzger & Phillips, *supra* note 10, at 474 n.2.

81. *See* Barnett & Becker, *supra* note 10, at 446 (remarking that in some cases promissory estoppel permits courts to enforce promises that are intended to be legally binding but fail to satisfy some technical requirement of contract law, while in other cases promissory estoppel serves to punish misrepresentation).

82. 813 F.2d 810 (7th Cir. 1987).

seller permitted the buyer to take over negotiation for the license. With the seller's advice, the buyer acquired the license, but then refused to go forward with the purchase of assets. Although the parties focused on the question of whether the letter of intent constituted a contract,[83] the court remanded the case to determine whether, under promissory estoppel, the seller could be compensated for turning over the license negotiation.[84]

A more famous application of promissory estoppel to permit recovery of precontractual investments is *Hoffman v. Red Owl Stores*.[85] In *Hoffman* a prospective franchisee approached the Red Owl grocery franchise about starting his own business. Red Owl encouraged Hoffman, but required him to make substantial investments as a condition to receiving an actual offer.[86] Hoffman complied initially, but gave up and sued when the franchisor countered with new, more exacting demands. The court ruled in favor of Hoffman and awarded him his out-of-pocket expenses.[87] Cases factually and analytically similar to *Hoffman* are now regularly litigated under the doctrine of promissory estoppel.[88]

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83. The court found that the letter of intent was not a contract. *Id.* at 814-17.

84. *Id.* at 817-18.

85. 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

86. Hoffman owned a small bakery. In preparation for performance as a Red Owl franchisee, he took the following steps: (1) sold his bakery at a loss of $2000; (2) bought a small grocery store to train himself in the grocery business; (3) later sold the grocery store at roughly his cost; (4) put $1000 down on the land where the Red Owl store would be constructed; and (5) incurred moving expenses to the town where the franchise would be located. These preparations took roughly three years, after which the franchisor raised the capital investment required to buy the franchise from $18,000 to $34,000 and placed more restrictive terms on Hoffman's ability to borrow money from his father-in-law. *Id.* at 699-701, 133 N.W.2d at 275-76; *see also* M. Chirelstein, Concepts and Case Analysis in the Law of Contracts 51-52 (1990) (discussing the facts of *Hoffman*).

87. *Hoffman*, 26 Wis. 2d at 696-97, 133 N.W.2d at 274. On remand, Hoffman won a settlement of $10,000 from Red Owl after a day and a half of trial. Hoffman went on to become an award-winning salesperson for Metropolitan Life Insurance Company. Kidwell, Macaulay, Thome & Whitford, Contracts I: The Wisconsin Contracts Materials, Book 2 498-99 (1985) (quoting conversations between the authors and Hoffman's Wisconsin lawyer). It should be noted that, unlike the situation in *Skycom*, the defendant in *Hoffman* did not benefit directly from the performing party's commitment of resources to the transaction. Red Owl could not "appropriate" Hoffman's readiness to be a franchisee. Red Owl, however, could benefit from Hoffman's increased skills. Hoffman's readiness to perform gave Red Owl better options for distribution in Hoffman's area at no cost to Red Owl. Other courts similarly have recognized promissory estoppel as a basis for damages when franchisors have strung prospective franchisees along, induced them to make precontractual expenditures, and then refused to go through with the deal. *See, e.g.*, Cincinnati Fluid Power, Inc. v. Rexnord, Inc., 797 F.2d 1386 (6th Cir. 1986) (remanding for new trial based on erroneous jury instruction); Werner v. Xerox Corp., 732 F.2d 580 (7th Cir. 1984); Walters v. Marathon Oil Co., 642 F.2d 1098 (7th Cir. 1981); Goodman v. Dicker, 169 F.2d 684 (D.C. Cir. 1948); Chrysler Corp. v. Quimby, 51 Del. 264, 144 A.2d 123 (1958).

86. *See, e.g.*, Nimrod Mktg. (Overseas) v. Texas Energy Inv. Corp., 769 F.2d 1076, 1080 (5th Cir. 1985) (holding that a purchasing agent who acquired equipment and materials for a Nigerian housing project could recover precontractual performance expenses based on promissory estoppel

ii. Unjust Enrichment

When one party's partial performance during negotiation actually confers a benefit on the other, the equitable doctrine of unjust enrichment can provide an alternative theory of recovery for the victim of opportunistic conduct. Damages based on unjust enrichment, however, sometimes do not compensate the performing party for the full value of its services because, as *Hoffman* demonstrates, not all preparations for performance directly benefit the other side. Nevertheless, the courts have defined "enrichment" broadly enough to overcome this problem in precontractual opportunism cases.

In *Earhart v. William Low Co.*,[89] for example, a landowner and a contractor made an agreement for the construction of a trailer park, subject to financing. Before obtaining financing, the landowner asked the contractor to begin clearing two parcels of land. The landowner already owned one of the parcels and was to obtain the second with his new financing. The owner could not arrange financing for the two-parcel deal, but later obtained financing for a smaller project involving only his own parcel. He went forward with the development, but he refused to pay for the first contractor's clearing work and used another

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when the owners backed out because of their failure to conclude a primary contract with Nigerian joint venturers), *cert. denied*, 475 U.S. 1047 (1986); Kiely v. St. Germain, 670 P.2d 764 (Colo. 1983) (finding relief under promissory estoppel for a prospective small business partner who quit his job, mortgaged his home, and moved to the location of a new business only to be asked at the last minute to become an employee instead of co-owner); Hunter v. Hayes, 533 P.2d 952 (Colo. Ct. App. 1975) (awarding two month's lost wages to employee who quit her job in reliance on a promise of new employment but was refused a job); Elgin Nat'l Indus. v. Howard Indus., 264 So. 2d 440 (Fla. Dist. Ct. App. 1972) (applying promissory estoppel to real estate transaction after buyer spent funds to apply for mortgage and began engineering studies for the move with the seller's knowledge and approval, who then sold the land to another for a higher price); Wheeler v. White, 398 S.W.2d 93 (Tex. 1965) (finding that a borrower who demolished a building and cleared land for construction of a new building was entitled to relief on the basis of promissory estoppel when lender that requested these actions refused to go through with the loan). An analogous set of cases has granted relief when, rather than making contract-specific investments, the plaintiff foregoes advantageous opportunities based on assurances that the negotiation process will result in a final deal. Forbearance constitutes a commitment to the negotiation process no less than actual expenditures of money. *See, e.g.*, Greenstein v. Flately, 19 Mass. App. Ct. 351, 474 N.E.2d 1130 (1985) (finding a commercial landlord liable under promissory estoppel and state FTC Act for relocation expenses and extra rent after drawing out negotiations with an existing commercial tenant then closing a deal with another tenant); Ned Nastrom Motors, Inc. v. Nastrom-Peterson-Neubauer Co., 338 N.W.2d 64 (N.D. 1983) (awarding damages based on promissory estoppel when creditor did not file lawsuit or institute bankruptcy proceedings because of assurances that settlement of debt would be worked out agreeably). One commentator has suggested that courts utilize the tort of negligent misrepresentation to address situations like that in *Hoffman*. *See* Gergen, *supra* note 10, at 34-46. He cites one case that has found liability in a *Hoffman*-like situation using this theory. *See* Giant Food v. Ice King, 74 Md. App. 183, 192-94, 536 A.2d 1182, 1186-87, *cert. denied*, 313 Md. 7, 542 A.2d 844 (1988).

89. 25 Cal. 3d 503, 600 P.2d 1344, 158 Cal. Rptr. 887 (1979); *see also* Farnsworth, *supra* note 10, at 223-24.

contractor to complete the project. The first contractor sued for the work performed on both tracts, claiming unjust enrichment. The trial court narrowly defined "enrichment" and awarded compensation only for the work on the owner's property because the work on the adjacent land did not directly benefit the owner. The Supreme Court of California, however, ruled that the contractor was entitled to compensation for work on both tracts, stating that "a defendant who receives the satisfaction of obtaining another person's compliance with the defendant's request to perform services incurs an obligation to pay for labor and materials expended in reliance on that request."[90] This reformulation of the elements of unjust enrichment greatly enlarges the scope of the claim. This broader definition also demonstrates the lengths to which courts will go to compensate fully victims of opportunism who have committed contract-specific assets during the negotiation process.[91]

iii. Breach of Agreement to Negotiate in Good Faith

A recent judicial innovation in cases focusing on the precontractual period is the recognition of express or implied promises to bargain in good faith.[92] Under traditional contract jurisprudence, "agreements to agree" are too indefinite to be enforced.[93] A judicial sensitivity to the dangers of opportunism in the negotiation process, however, has loosened the judicial attitude toward indefinite agreements, resulting in judgments against parties who refuse to honor agreements to negotiate after inducing others to make expenditures.

A leading case is *Channel Home Centers v. Grossman*.[94] In *Channel Home Centers* a shopping mall developer and a prospective tenant signed a letter of intent that specified the general framework on which

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90. *Earhart*, 25 Cal. 3d at 510, 600 P.2d at 1345, 158 Cal. Rptr. at 891.

91. *See* Precision Testing Laboratory v. Kenyon Corp., 644 F. Supp. 1327, 1350-51 (S.D.N.Y. 1986) (awarding damages for unjust enrichment based on services performed by a potential joint venture partner while the agreement was being negotiated).

92. Although judicial recognition of contracts to bargain in good faith is recent, legal scholars have explored the problem for decades. *See* Dugdale & Lowe, *Contracts to Contract and Contracts to Negotiate*, 1976 J. BUS. L. 28; Farnsworth, *supra* note 10; Holmes, *The Freedom Not to Contract*, 60 TUL. L. REV. 751 (1986); Knapp, *Enforcing the Contract to Bargain*, 44 N.Y.U. L. REV. 673 (1969). This duty is already part of American labor law by statute. *See* Taft-Hartley Act § 8(d), 29 U.S.C. § 158(d) (1988); R. GORMAN, BASIC TEXT ON LABOR LAW, UNIONIZATION AND COLLECTIVE BARGAINING 399-495 (1976); Cox, *The Duty to Bargain in Good Faith*, 71 HARV. L. REV. 1401 (1958).

93. *See, e.g.*, John Bleakley Ford, Inc. v. Estes, 164 Ga. App. 547, 298 S.E.2d 270 (1982) (refusing to enforce because of indefiniteness an oral promise that landlord would enter into a new lease agreement with car dealership); Yan's Video, Inc. v. Hong Kong TV Video Programs, 133 A.D.2d 575, 520 N.Y.S.2d 143 (1987) (refusing to enforce a statement in a licensing agreement that the licensor will negotiate in good faith to renew agreements for an additional year on terms to be negotiated).

94. 795 F.2d 291 (3d Cir. 1986).

the parties would negotiate specific lease terms. The developer used the tentative agreement to get financing for the project. The letter provided, somewhat cryptically, that upon signing the landlord would "withdraw the Store from the rental market, and only negotiate the above described leasing transaction to completion."[95] Pursuant to this preliminary agreement, the tenant spent approximately twenty-five thousand dollars preparing to occupy the space. Before the lease was finalized or signed, the landlord reneged and accepted another tenant willing to pay higher rent. The original tenant filed suit. The court held that the promise to "negotiate" in the letter of intent was binding and was breached when the landlord backed out of the deal. This breach entitled the prospective tenant to recover the twenty-five thousand dollars spent on preparation.[96]

Channel Home Centers was premised on the breach of an express contract to bargain in good faith. Other courts have recognized promises to bargain in good faith based on promissory estoppel. In *Arcadian Phosphates, Inc. v. Arcadian Corp.*[97] the Second Circuit pointed to a promise "to cooperate" in a letter of intent as a possible basis of a promissory estoppel claim for precontractual expenses. Arcadian Corp. entered into negotiations to sell its fertilizer business to a joint venture group called Arcadian Phosphates, Inc. (API).[98] The parties executed a preliminary agreement specifying the sale price, the assets for sale, and the closing date. The agreement further specified that the parties would "cooperate fully and work judiciously in order to expedite the closing date and consummate the sale of the business."[99] During the negotiation process, however, the price of phosphates rose dramatically, and Arcadian Corp. reneged on its prior agreement to take only five percent equity in the new joint venture. In light of the new market conditions, Arcadian Corp. demanded a majority stake in the venture.[100] API sued to enforce the preliminary agreement as an actual contract. The court found that the preliminary agreement did not amount to a contract to sell the company. The court did hold, however, that API could make a promissory estoppel claim for losses incurred during the precontractual

95. *Id.* at 293.

96. *Id.* at 300; *see also* Chase v. Consolidated Foods Corp., 744 F.2d 566, 571 (7th Cir. 1984); OAO Corp. v. United States, 17 Cl. Ct. 91, 100-02 (1989) (precontractual investments that were reimbursed were based on an oral, implied-in-fact contract); Waltentas v. Lipper, 636 F. Supp. 331, 335 (S.D.N.Y. 1986); Goodstein Constr. Corp. v. City of New York, 67 N.Y.2d 990, 992, 494 N.E.2d 99, 100, 502 N.Y.S.2d 994, 995 (1986).

97. 884 F.2d 69 (2d Cir. 1989).

98. *Id.* at 70.

99. *Id.* at 70-71.

100. *Id.* at 71.

period based on a possible breach of the seller's promise to cooperate fully in consummating the sale.[101]

iv. Promissory Fraud

The tort of promissory fraud renders a negotiator liable for making promises that the negotiator had no intention of keeping at the time they were made.[102] All but two American jurisdictions recognize liability for fraudulent promises.[103] Strict evidentiary requirements on the intent element would render this claim a legal rarity because the promisor's subjective intent not to keep a promise is difficult to prove definitively.[104] The courts, however, have not uniformly required strict proof of intent. Fraudulent intent cannot be inferred solely from nonperformance of the promise,[105] but circumstantial evidence, such as sharp dealing throughout the transaction[106] or a refusal to acknowledge that a contract was made,[107] can establish a prima facie case of promissory fraud.

When victims of opportunistic conduct are induced to make contract-specific investments or to forego unique opportunities during the negotiation process, promissory fraud sometimes has furnished relief. Unlike the previously mentioned theories of recovery, the victims of opportunism in promissory fraud cases often are induced to enter into a contract before evidence of the defendant's precontractual opportunism surfaces. In many promissory fraud cases, however, precontractual commitment of resources to performance constitutes a major source of damages.

In the typical promissory fraud case, an employer, aware that it has no definite hiring needs, promises a prospective employee long-term employment. After the employee quits her existing job and moves to new a location, the employer denies employment altogether or fires the employee after only a short period of work.[108] Other examples of prom-

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101. *Id.* at 73-74.

102. W. KEETON, D. DOBBS, R. KEETON & D. OWEN, PROSSER AND KEETON ON TORTS § 109, at 762-65 (5th ed. 1984) [hereinafter PROSSER & KEETON]; Wangerin, *Damages for Reliance Across the Spectrum of Law: Of Blind Men and Legal Elephants*, 72 IOWA L. REV. 47, 58-65 (1986).

103. PROSSER & KEETON, *supra* note 102, § 109, at 763 (noting that only Indiana and Illinois reject the doctrine).

104. Hodges v. Pittman, 530 So. 2d 817, 819 (Ala. 1988) (stating that "subjective intent [not to keep a promise] can rarely, if ever, be conclusively proven").

105. *Id.* at 818; Britt v. Britt, 320 N.C. 573, 579, 359 S.E.2d 467, 471 (1987).

106. Hanover Modular Homes v. Scottish Inns, 443 F. Supp. 888, 891-92 (W.D. La. 1978); Breier v. Koncen Meat Co., 762 S.W.2d 499, 500 (Mo. Ct. App. 1988).

107. New Process Steel Corp. v. Steel Corp., 703 S.W.2d 209, 214 (Tex. Ct. App. 1985).

108. *See, e.g.*, Hamlen v. Fairchild Indus., 413 So. 2d 800 (Fla. Dist. Ct. App. 1982); Annotation, *Employer's Misrepresentation As to Prospect, or Duration, of Employment As Actionable Fraud*, 24 A.L.R.3D 1412, § 5 (1969). Some courts hold that as a matter of law employees at will

issory fraud include cases in which franchisors induce prospective franchisees to make downpayments and expend resources in preparation for performance at a time when the franchisor is bankrupt[109] or has plans to abandon the geographical area in which the franchise is to be located.[110]

Gadsden Paper & Supply Co. v. Washburn[111] represents an interesting example of the opportunistic scheme captured by promissory fraud. Gadsden Paper, a business supply company, entered into negotiations to buy Mr. Washburn's sole proprietorship, Gadsden Solvent and Supply Corp. Gadsden Paper historically had expanded its business by acquiring smaller companies and absorbing their employees.[112] Instead of simply buying Washburn's business for the agreed purchase price of seventy-two thousand dollars, Gadsden Paper insisted that Washburn sign an employment agreement that provided for payment of seventy-two thousand dollars over a two-year period in the form of commissions from sales generated by Washburn as a Gadsden Paper employee. Under the agreement, if Washburn's sales generated more than seventy-two thousand dollars in commissions during this period, he would receive the total amount earned. In no event, however, could he receive less than seventy-two thousand dollars. Washburn signed the employment agreement, became a Gadsden Paper employee, sold his inventory to Gadsden Paper at cost, introduced Gadsden Paper employees to his existing customers, and began sharing accounts with Gadsden Paper salespeople.[113] Shortly thereafter, Gadsden Paper fired Washburn and refused to pay the seventy-two thousand dollars, claiming that Washburn was terminable at will under the employment agreement. The court agreed that Gadsden Paper had not breached the employment contract, but upheld a promissory fraud award of two hundred fifty thousand dollars, which included punitive damages. The court found that Gadsden Paper "set up" Washburn in a scheme essentially to steal his business.[114]

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have no claim based on promissory fraud. *See* Lanham v. Mr. B's Oil Co., 166 Ga. App. 372, 304 S.E.2d 738 (1983); Ely v. Stratoflex, Inc., 132 Ga. App. 569, 208 S.E.2d 583 (1974).

109. *See* Ellis v. Zuck, 409 F. Supp. 1151 (N.D. Ala. 1976), *aff'd*, 546 F.2d 643 (5th Cir. 1977).

110. *See* Alexander v. Texaco, Inc., 530 F. Supp. 864 (D. Mont. 1981).

111. 554 So. 2d 983 (Ala. 1989).

112. *Id.* at 987.

113. *Id.* at 985-86.

114. *Id.* at 987. Another good example of opportunistic bargaining conduct litigated under the tort theory of promissory fraud is Markov v. ABC Transfer & Storage Co., 76 Wash. 2d 388, 457 P.2d 535 (1969). In *Markov* a commercial tenant entered into negotiations with its landlord to renew its lease on a warehouse and railroad yard. The warehouse was vital to the tenant's continued business relationship with its main client, the Scott Paper Company, which used the warehouse as a regional product distribution facility. Representatives from the tenant, the landlord, and Scott attended the renewal negotiations. Scott's contract with the tenant also was up for re-

c. Commitments to Third Parties

The negotiation of complex transactions often occurs in the context of concurrent negotiations between the principal bargainers and others whose cooperation is needed to execute the final project. Complex construction projects, for example, often require parallel negotiations among various combinations of architects, owners, contractors, subcontractors, and lenders. The timing of the commitments to these contracts sometimes creates the danger of precontractual opportunism. The danger grows as parties become unevenly committed to the transaction by virtue of their need to create transaction-specific contracts with third parties. Similarly, when a commodity buyer intends to resell and prematurely commits to a secondary transaction based on the seller's assurances, the buyer will find itself in a vulnerable position if the seller then seeks to renegotiate the terms of the deal.

Textbook examples of judicial responses to the problem of uneven commitments to third parties can be found in *James Baird Co. v. Gimbel Bros.*[115] and *Drennan v. Star Paving Co.*[116] In *Gimbel* the Pennsylvania Department of Highways invited bids on the construction of a public building. Gimbel, a linoleum supplier, obtained specifications for the linoleum necessary for the job. Gimbel then sent out fixed-price offers to supply linoleum to thirty prime contractors expected to bid on the project. Baird received one of these offers and used it in preparing its bid.[117] After Baird submitted its bid, Gimbel notified Baird that it had made a mistake and that the job actually would require twice the

newal and depended on the tenant having a long-term lease. The landlord assured all parties assembled that the tenant's lease would be renewed for a three-year term. Consequently, neither the tenant nor Scott took any further steps to seek another suitable location. Unbeknownst to the tenant and Scott, however, the landlord secretly was negotiating to sell the subject property to the Boeing Company. The lease negotiations were merely a secondary option for the landlord. The sale to Boeing went through. As a result, the tenant lost the Scott Paper contract and incurred extraordinary expenses in relocating. The court found that the landlord's promise regarding the lease renewal was fraudulent. It awarded damages for the tenant's lost profits from the Scott Paper contract and required the defendant to pay the tenant's moving expenses to a new location. *Id.* at 388, 457 P.2d at 535; *see also* Ealing Corp. v. Harrods Ltd., 790 F.2d 978, 979 (1st Cir. 1986) (plaintiff claimed that defendant induced it to spend money on a "pilot program" to distribute defendant's catalogue in the United States during negotiations for a long-term distribution contract when defendant never intended to enter a long-term contract).

115. 64 F.2d 344 (2d Cir. 1933) (L. Hand, J.).

116. 51 Cal. 2d 409, 333 P.2d 757 (1958) (Traynor, J.).

117. *Gimbel*, 64 F.2d at 345. In general, prime contractors are bound by their bids once they are submitted unless the bid is revokable or contains a mistake that excuses performance. E. FARNSWORTH, *supra* note 48, § 9.4, at 664. Some project owners require prime contractors to submit "bid bonds" to secure the contractor's performance at the stated price should that contractor's bid be chosen. Comment, *The Sub-Contractor's Bid: An Option Contract Arising Through Promissory Estoppel*, 34 EMORY L.J. 421, 428 n.14 (1985).

estimated amount of linoleum.[118] Gimbel withdrew its bid and attempted to substitute a corrected offer. Baird, which subsequently was awarded the contract, sued to hold Gimbel to its original bid. Using standard offer-and-acceptance contract theory, Judge Learned Hand refused to bind Gimbel to its bid. He held that withdrawal was permitted because no contract had been formed at the time Gimbel withdrew its offer.[119]

Gimbel's approach toward the subcontractor-contractor relationship has been rejected by most modern courts.[120] The revisionist view is exemplified by Justice Roger Traynor's opinion in *Star Paving*, which held that a subcontractor's bid is binding under promissory estoppel until the prime contractor has had a chance to accept the subcontractor's bid after being awarded the general contract.[121] This result, said Justice Traynor, "is only fair."[122]

The seemingly conflicting results in *Gimbel* and *Star Paving* can be reconciled through an examination of the cases with an eye to the potential for opportunism in the construction bidding process. The facts in the two cases differ in a way that has not caught the attention of most commentators. In *Gimbel* the subcontractor discovered and communicated its mistake to all thirty bidding contractors before anyone

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118. *Gimbel*, 64 F.2d at 345.

119. *Id.* at 346.

120. *See* RESTATEMENT (SECOND) OF CONTRACTS § 87(2) (1981) (stating that an offer that is reasonably expected to induce reliance or forbearance of a substantial character before acceptance and that actually causes reliance "is binding as an option contract to the extent necessary to avoid injustice"); Feinman, *supra* note 10, at 693 n.72 (and cases cited therein); Comment, *supra* note 117, at 435.

121. *Star Paving*, 51 Cal. 2d at 415, 333 P.2d at 760.

122. *Id.* Courts have required subcontractors to honor their original hids even when the prime contractor consents to a subcontractor's demand for renegotiation after the main contract has heen awarded. *See* Montgomery Indus. Int'l v. Thomas Co., 620 F.2d 91 (5th Cir. 1980) (holding that consent was void because it was obtained under duress). The *Star Paving* ruling opens the door to another form of opportunism, this time by the prime contractor. After *Star Paving*, the prime contractor knows that the subcontractor is bound to perform at a stated price once the bid is submitted. Upon being awarded the contract, the prime contractor may attempt to solicit still lower bids from other subcontractors. This practice is known as "bid shopping" in the construction industry. Constructors Supply Co. v. Bostrom Sheet Metal Works, 291 Minn. 113, 121, 190 N.W.2d 71, 76 (1971). The contractor also may try to negotiate with the original subcontractor to reduce the subcontractor's bid. This practice is known as "bid chopping" or "bid chiseling." *Id.*; Comment, *Construction Bidding Problems: Is There a Solution Fair to Both the General Contractor and the Subcontractor?*, 19 ST. LOUIS U.L.J. 552, 563-66 (1975). Justice Traynor perceived and tried to prevent this danger by stipulating that the prime contractor is "not free to delay acceptance after he has been awarded the general contract in the hope of getting a better price. Nor can he reopen bargaining with the subcontractor and at the same time claim a continuing right to accept the original offer." *Star Paving*, 51 Cal. 2d at 415, 333 P.2d at 760. Other courts have affirmed this reciprocal limiting principle. *See, e.g.*, Preload Technology, Inc. v. A.B. & J. Constr. Co., 696 F.2d 1080 (5th Cir. 1983); Thomas Constr. Co. v. Kelso Marine, Inc., 639 F.2d 216 (5th Cir. 1981); R.J. Daum Constr. Co. v. Child, 122 Utah 194, 247 P.2d 817 (1952).

was awarded the contract.[123] In *Star Paving*, by contrast, the subcontractor waited until after it learned that its offer was part of the winning bid to announce its desire to renegotiate.

This distinction makes little difference from the prime contractor's standpoint because, absent a patently obvious mistake, the prime contractor is committed to the deal as soon as its bid is submitted.[124] From the standpoint of deterring opportunistic behavior by subcontractors, however, both *Gimbel* and *Star Paving* reach the correct result. Before the contract is awarded, the subcontractor maximizes both its and the prime contractor's chances of getting the work by keeping its bid as low as possible. The danger of an opportunistic bid withdrawal, therefore, is minimal assuming there is competition for the subcontract. After the contract is awarded and the subcontractor knows its bid is part of the winning package, however, it may feel tempted to raise its price to an amount just below its closest competition, claiming it had made a "mistake." Even a significant error is suspect in these circumstances. Under this analysis, Judge Hand and Justice Traynor both responded correctly to the potential for opportunism embedded in the facts presented to them.

Star Paving and its progeny demonstrate a judicial willingness to deter opportunism when the coordination of parallel contract negotiations requires uneven commitments. A lesser known example of the same principle appears in an unusual interpretation of the law of fraud to cover misstatements by an agent of a principal's reservation price.

Perhaps the most guarded information in commercial negotiation is each party's reservation price or "bottom line." By misrepresenting their bottom lines negotiators frequently create false impressions regarding the range within which they are able to make a deal. Their aim is to bluff their opponents into surrendering a large share of the surplus that is actually available in the transaction.[125] It is an accepted negotiating tactic to exaggerate or obscure the minimum or maximum amount that a party will accept in order to alter the opponent's estimate of likely agreement points.[126] One of the *Model Rules of Professional Con-*

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123. Indeed, Gimbel sent word of its mistake on the same day that Baird submitted its bid. The notice simply arrived a few hours too late. *Gimbel*, 64 F.2d at 345.

124. *See* Comment, *supra* note 117, at 428 (stating that the prime contractor "is bound (and probably bonded) to perform for the bid he has submitted").

125. R. FRANK, *supra* note 16, at 165 (remarking that "reservation prices are often difficult to discern in practice" and that the "art of bargaining, as most of us eventually learn, is in large part the art of sending misleading messages about them").

126. *See* RESTATEMENT (SECOND) OF AGENCY § 348 comment d (1981) (stating that principals and agents are "permitted to misstate without liability in deceit the lowest price at which [they are] willing to sell, or the highest price at which [they are] willing to buy"). Many commentators do not even consider misstatements about reservation price to be lies. Rather, they refer to them

duct, for example, provides that "estimates of price or value placed on the subject of a transaction and a party's intentions as to an acceptable settlement of a claim" are not material facts for purposes of prohibiting lawyers from making false statements to a third person.[127] The few cases that have addressed the issue directly hold that parties and their agents can make such misrepresentations without fear of legal sanction.[128]

One of the few cases that runs contrary to this line of authority concerns a buyer who prematurely committed to a resale contract and fell victim to a seller's opportunistic agent. In *Collins v. Philadelphia Oil Co.*[129] a buyer agreed orally with a seller's agent to pay fifty-five hundred dollars for an oil and gas lease. The buyer then contracted to sell the lease to a coal company, which the seller's agent learned before the final papers were delivered on the original sale. When the buyer arrived to finalize the lease, the agent falsely announced that the owner had reconsidered and would not take less than ten thousand five hundred dollars for the lease. To avoid breaching the contract with the coal company, the buyer paid the new amount. When he later learned that the agent had lied, however, he sued for fraud.

The court acknowledged that the buyer and seller were engaged in an arm's length transaction in which the buyer received what he paid for with "his eyes open."[130] Nevertheless, the court refused to hold that the agent's false assertion regarding the owner's price was mere "dealer's talk" and determined that the buyer justifiably could rely on the misrepresentation.[131] As the *Model Rules of Professional Conduct*

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as "bluffs." *See* P. Ekman, Telling Lies 69-70 (1985) (asserting that "[b]ecause the participants expect misinformation, not the truth, bargaining . . . [does not] meet any definition of lying"); H. Raiffa, The Art and Science of Negotiation 142 (1982) (asserting that most people would not consider self-serving negotiating stances and exaggerations to be "lying").

127. Model Rules of Professional Conduct Rule 4.1(a) comment (1983).

128. *See, e.g.*, Morta v. Korea Ins. Corp., 840 F.2d 1452, 1456 (9th Cir. 1988) (finding no claim for fraud when an insurance agent falsely represented that the insurance company could pay no more than $900 to an accident victim). Agents are generally free to make these misrepresentations as long as they do not violate a duty to their principal. Restatement (Second) of Agency § 348 comment d.

129. 97 W. Va. 464, 125 S.E. 223 (1924).

130. *Id.* at 469, 125 S.E. at 225.

131. The court reasoned:

> We . . . demand a more conscionable morality. It may be true in some cases, as suggested, that a buyer should be held to the responsibility of knowing that agents are prone to boost the value of the wares at their disposal. That should always be true to a certain extent, but positive misrepresentations as to the price set upon them by the owners go quite beyond the scope of clever salesmanship. We do not consider that the doctrine of caveat emptor either now or ever has been a complete shield to all sorts of false bargaining. . . . We are inclined to hold that, where an agent states that his principal has fixed a certain price, a matter as to which no one could he more accurately informed than the agent himself, in most cases the buyer has the right to rely upon that statement.

and *Restatement (Second) of Agency* make clear, however, most agents can lie about their principal's reservation price without being sanctioned.[132] The only general exception arises when a seller's agent exaggerates the seller's price, receives that price, and then secretly pockets the difference between the inflated price paid and the amount the seller actually was willing to take.[133] The real vice in *Collins* was not that the agent misrepresented the asking price, but that he tried opportunistically to take advantage of the buyer's premature commitment to a third party.

III. Opportunism and the Dilemma of Trust

The legal developments described in Part II are not new. Nor have traditional legal scholars criticized them. Indeed, recognition of doctrines such as promissory estoppel and contracts to bargain in good faith generally have been heralded by most commentators as welcome alternatives to the rigid legal formalism of the late nineteenth and early twentieth centuries.[134] Scholars have pointed out that these doctrines give courts the flexibility to "do justice" in individual cases and to focus on the interests of the transacting parties instead of inflexible legal doctrines.[135] Various stories have been offered to explain the rise of this

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Id.

132. *See supra* notes 126-27 and accompanying text.

133. *See* Siler v. Gunn, 117 Ga. App. 325, 160 S.E.2d 427 (1968) (holding a broker liable as agent of buyer); Hokanson v. Oatman, 165 Mich. 512, 131 N.W. 111 (1911) (holding broker liable who lied to both buyer and seller and pocketed $300 out of the $1200 paid for the property); Restatement (Second) of Agency § 348 comment d (stating that broker is liable for misrepresentation of seller's minimum price if done to serve his own interests in violation of his duties to the owner).

134. Most traditional legal scholars have approved of doctrines such as promissory estoppel and express contracts to bargain in good faith on the grounds that these doctrines free courts from the rigid formalism of traditional contract law and permit courts to keep pace with changing practices in the marketplace. *See, e.g.*, Henderson, *Promissory Estoppel and Traditional Contract Doctrine*, 78 Yale L.J. 343, 386 (criticizing courts that take a highly formal approach to promissory estoppel because such an approach "woodenly directs attention away from considerations of justice and the extent of reliance, and focuses instead upon relatively inflexible and narrow bargain-oriented rules"); Farnsworth, *supra* note 10, at 286 (approving contracts to bargain in good faith); Knapp, *supra* note 92, at 726-28 (same). Critical legal scholars and contemporary formalists, however, have criticized these doctrines as being too indeterminate when applied. *See, e.g.*, Feinman, *supra* note 10, at 689-90 (asserting that promissory estoppel's indeterminacy "prevents the development of clear guidelines for judicial decision"); Gibson, *Promissory Estoppel, Article 2 of the U.C.C., and the Restatement (Third) of Contracts*, 73 Iowa L. Rev. 659, 708-15 (1988) (arguing that promissory estoppel is too vague and should be replaced by a theory focusing on the actual agreement between the parties).

135. *See, e.g.*, Feinman, *supra* note 10, at 684-85 (arguing that promissory esteppel is part of the postclassical approach to contract law that emphasizes the basic interests of contracting parties rather than formalities); Metzger, *The Parol Evidence Rule: Promissory Estoppel's Next Conquest?*, 36 Vand. L. Rev. 1383, 1408-09 (1983) (noting that courts sought a flexible doctrinal device to "do justice" in reliance cases).

modern focus on contextualism.[136]

Although scholars have described accurately the "rise and fall" of formal contract law and the possible socioeconomic explanations for these trends,[137] they have failed to present a unified framework for discussing the modern legal treatment of the negotiation phase of commercial transactions.[138] The economic concepts of opportunism and transaction-specific investments offer the needed framework and describe the conditions under which liability arises, at least with respect to the foregoing set of precontractual cases.[139] As demonstrated in Part II, courts are concerned with the precontractual investment of transaction-specific assets and the opportunistic exploitation of these investments. This insight prompts the following fundamental question: If contract law is available to protect investments, why do rational commercial parties risk assets in the precontractual stage? The answer lies in the social psychology of negotiation and the processes by which people build mutually trusting bargaining relationships.

As noted earlier, many social scientists view negotiation as more than just a process of dickering over explicit terms and conditions of exchange.[140] Rather, negotiation is a laboratory for the construction of

136. H. COLLINS, THE LAW OF CONTRACT 11 (1986) (suggesting that a breakdown of formal contract doctrine was caused by the infusion of "communitarian" values into law); G. GILMORE, THE DEATH OF CONTRACT 94-96 (1974) (providing a historical account based on evolution of "welfare state and beyond"); Farber & Matheson, *supra* note 18, at 904-06 (giving an efficiency justification for expanded application of promissory estoppel and arguing that the reliance element should be dropped in commercial cases); Metzger & Phillips, *supra* note 10, at 500-08 (giving a historical account based on rise of big corporations).

137. *See, e.g.*, P. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT (1979).

138. Professor Juliet Kostritsky has attempted to link one legal doctrine governing negotiation with the realities of the bargaining arena. She has argued that promissory estoppel cases can be explained by the existence of "persuasive barriers to, or explanations for the parties dispensing with, explicitly reciprocal or formalized contracting" and "a plausible benefit to the promisor [that] can be identified." Kostritsky, *A New Theory of Assent-Based Liability Emerging Under the Guise of Promissory Estoppel: An Explanation and Defense*, 33 WAYNE L. REV. 895, 905-06 (1987). This theory is both too limited, in that it addresses only the doctrine of promissory estoppel, and too broad, in that it attempts to incorporate cases in which promises substitute for consideration and cases that deal with bargaining malfeasance. The concept of bargaining opportunism captures greater doctrinal variety within the confines of a more specific commercial activity. To her credit, Professor Kostritsky identifies "trust and confidence relations" as one occasion in which parties relax their reliance on bargaining formalities. *Id.* at 905 n.28, 927-29, 937-38. She tends to rely only on traditional trust-based relationships, however, such as family ties and dealings between conventional fiduciaries and their beneficiaries. This Article's thesis is that trust is an important factor even in arm's length negotiations.

139. A more complete description of negotiation regulation would include an analysis, perhaps based on Williamson's broad version of the concept of opportunism, *see supra* notes 24-26 and accompanying text, of the legal rules governing fraud and nondisclosure. Such an analysis, however, is beyond the scope of this Article.

140. *See supra* note 51 and accompanying text.

relationships between business actors.[141] An important part of these relationships is an understanding of the degree of trust that the parties repose in one another.[142] Some parties seek trusting business relations to secure efficiency gains. Others are conditioned by psychological or philosophical predispositions to seek trusting relations. In either case, risking assets appears to be an important signal in the processes of searching out trustworthy business partners, constructing trusting relationships, and maintaining trust once it is established.

A. *The Dilemma of Trust*

Parties negotiate because they feel that coordinating their goals with the goals of others will yield better results than acting alone.[143] In a world in which people act to maximize their own gains from trade, this process of coordination and cooperation is fraught with difficulty. Scholars have long recognized that most negotiations present bargainers with mixed incentives that make cooperation extremely difficult.[144] Negotiators want to receive the benefit of cooperation, but also seek to minimize their exposure to risk of exploitation.[145]

Conflict theorist Morton Deutsch has suggested three basic ways in which parties solve the mixed-motive problem to guarantee that an exchange will be reciprocated: (1) simultaneous exchange; (2) use of third parties; and (3) use of "hostages" or deposits to ensure commitment to the reciprocal arrangement.[146] These mechanisms are used frequently in

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141. *See supra* notes 51-59 and accompanying text.

142. *See infra* notes 152-56 and accompanying text. Indeed, research discloses that American managers lead the world in their tendency to trust in the context of commercial dealings. In a comparative study of nationalities, American managers scored highest in their tendency to trust, while Greek businesspeople scored highest in their tendency to be suspicious. *See* D. HARNETT & L. CUMMINGS, BARGAINING BEHAVIOR: AN INTERNATIONAL STUDY 124 (1980).

143. D. LAX & W. SEBENIUS, *supra* note 62, at 11 (stating that "[w]hen interdependence, conflict, and the potential for opportunism are present, people can negotiate to arrive at a joint decision that is better than their unilateral alternatives").

144. *See, e.g.*, R. LEWICKI & L. LITTERER, *supra* note 51, at 107 (finding that "[m]ost [bargaining] situatious are 'mixed motive' "); H. RAIFFA, *supra* note 126, at 33; J. RUBIN & B. BROWN, *supra* note 51, at 10.

145. As one commentator has put it:

> Mixed motive conflict is characterized by the presence of (a) tbe possibility of mutually beneficial cooperation, (b) the temptation to compete so as to exploit the other person's cooperation, (c) a lack of trust of the other person because of the possibility of his yielding to the temptation to exploit, and (d) the possibility of mutually harmful joint competition arising from both the temptation to compete and the requirement to compete to defend against exploitation.

Lindskold, *Trust Development, the GRIT Proposal, and the Effects of Conciliatory Acts on Conflict and Cooperation*, 85 PSYCHOLOGICAL BULL. 772, 772 (1978).

146. M. DEUTSCH, *supra* note 14, at 161. Commercial parties, unlike terrorists or nations under siege, do not use hostages in the literal sense. Some features of transactional exchange, however, can be analogized to the use of hostages to guarantee reciprocity in exchange. *See* Wil-

commercial negotiation to solve cooperation problems. Parties arrange for "closings" in which they exchange documents and funds simultaneously. Third parties such as escrow agents and sureties facilitate cooperation by guaranteeing performance. Indeed, the use of preliminary contracts enlists a third party—the state—to enforce bargaining norms to which the parties have agreed. Finally, money deposits assure that parties will go through with negotiations subject to specified conditions of performance.[147]

The use of these solutions, however, may be problematic for a number of reasons. First, simultaneous exchanges at preliminary bargaining stages conflict with the exploratory, give-and-take nature of negotiation. Second, the desired structure of the transaction may render mechanisms such as preliminary contracts too costly or awkward. Preliminary contracts setting out explicit duties during negotiation require additional bargaining, costly drafting, and still may be difficult to enforce.[148] Strategic concerns also limit the amount of preliminary bargaining in which parties are willing to engage. For example, demands for particular preliminary terms may reveal more about the party making the demand than the party wishes.[149] Preliminary dickering also may dissipate good will that the parties hope to draw on in the negotiation of the main contract.[150] Third, the use of third parties such as sureties and escrow agents is expensive and may be impractical at early stages of negotiations. Fourth, deposits are also costly and may discourage negotiations between parties with limited or illiquid assets.[151]

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liamson, *Credible Commitments: Using Hostages to Support Exchange*, 73 AM. ECON. REV. 519 (1983).

147. In real estate transactions, buyers often pay a deposit (downpayment) toward the purchase price that is forfeited if they abort the transaction without a proper excuse. *See, e.g.*, Lundstrom v. Hackle, 40 Colo. App. 322, 579 P.2d 85 (1978); Maxton Builders, Inc. v. Galbo, 68 N.Y.2d 373, 502 N.E.2d 184, 509 N.Y.S.2d 507 (1986). The bid bond used in construction contracts is another example of this device. *See supra* note 117. In the merger and acquisition sphere, some business brokers require a potential buyer to put up a cash deposit equal to the asking price "before he is permitted to dig through financial statements." Jamison, *Hunting that Elusive Creature, the Big Deal*, Wall St. J., July 30, 1990, at A8, col. 3. When the acquiring firm has more bargaining leverage, it may seek to negotiate a preliminary contract with the target firm that pays the buyer a "cancellation fee" if the seller walks away from the deal. Berkovitch, Bradley & Khanna, *Tender Offer Auctions, Resistance Strategies, and Social Welfare*, 5 J.L. ECON. & ORGANIZATION 395, 403 n.8, 404 (1989).

148. Courts only recently have begun to recognize contractual promises to bargain in good faith. *See supra* notes 92-101 and accompanying text.

149. Ayres & Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87, 94 (1989) (noting that one source of incompleteness in contracts is "strategic behavior by relatively informed parties," who are worried about revealing private information regarding preferences and intentions to the other side during negotiation).

150. Ring & Van de Ven, *supra* note 53, at 188 (arguing that extensive negotiation over contractual safeguards is essentially zero-sum bargaining that dissipates good will and trust).

151. One buyer looking to acquire a business commented that the deposit requirement im-

The awkwardness or expense of more formal means of assuring reciprocal exchange motivate parties to seek other ways of constructing cooperative bargaining relationships. The basis of all alternatives is one of the most fragile, yet powerful human dispositions—interpersonal trust.[152] Parties prefer to deal based on trust because it lowers the transaction costs inherent in the alternative approach of bargaining based on mutual suspicion. Moreover, trust signals that postcontractual relationships with the same or future partners can be based on mutually beneficial understanding and flexibility rather than on strict adherence to legal rights and contract terms.[153]

Business dealings grounded entirely in trust are rare,[154] particularly in the incipient stages of negotiations. Perhaps even more unusual, however, are successful business dealings that lack trust as a strong part of the relationship.[155] The cost savings that trust can yield are too great

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posed by some business brokers "is probably a screening method so brokers can be assured of dealing with buyers who are more stupid than they are." Jamison, *supra* note 147, at A8, col. 4.

152. The concept of trust is as difficult to define as opportunism. *See supra* notes 22-27 and accompanying text. As used in this Article, trust connotes a belief that others can be depended on and that they will not harm the party who reposes trust in them. Gambetta, *Can We Trust Trust?*, in COOPERATIVE RELATIONS, *supra* note 8, at 219 (asserting that "trusting a person means believing that when offered the chance, he or she is not likely to behave in a way that is damaging to us"). Action taken based on trust "increases one's vulnerability to another whose behavior is not under one's control . . . and . . . takes place in a situation where the penalty suffered if the trust is abused would lead one to regret the action." Lorenz, *supra* note 8, at 197.

153. B. BARBER, *supra* note 15, at 130 (asserting that "[w]hen differences occur over contract performance, businessmen resort to informal trustful dealings first and to legal procedures only as a last resort"). Research discloses that many commercial parties rely on mutual trust to resolve differences after contract performance has begun, even when they have negotiated an elaborate agreement. Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963). The ability to make such amicable adjustments arguably is related to the degree of trust that the parties establish in the negotiation stage of their relationship.

154. These relationships, however, do occur. For example, until recent reforms decentralized the contracting practices of the Soviet government, the USSR enjoyed an exceptional reputation for reliable payment for imported foreign goods. The *Wall Street Journal* recently reported that certain British trading companies dealt with the Soviets entirely "on trust," thus saving the substantial transaction costs associated with the institution of contract. Gumbel & Hays, *Perestroika Bombs at Its Big Tryout in the Trade Arena*, Wall St. J., June 21, 1990, at 1, col. 1. The article quoted a British trade executive as saying, "All our business here was on trust. . . . There were occasions when the contract was simply forgotten. We delivered and were paid." *Id.* Other firms report that they had been able to dispense with costly letters of credit and export insurance in their dealings with the USSR. *Id.* This desirable situation now has backfired as new Soviet managers in a staggering economy are refusing to pay for goods shipped. *Id.*

155. D. PRUITT, *supra* note 14, at 92 (remarking that even low-risk bargaining moves require "some degree of trust"). As one set of commentators has explained:

> Trust is the binding force in most productive buyer/seller relationships. No amount of detail in the formal written contract, no abundance of legal staff to fight for recompense, no form of recourse can provide the buyer with such a high expectation of a satisfying exchange relationship as a simple, basic trust of the salesperson and the company that he or she represents.

Hawes, Mast & Swan, *supra* note 14, at 1; *see also* Lorenz, *supra* note 8, at 209 (surmising that "[w]hile trust is costly, lack of trust is more costly still").

to ignore when evaluating potential contracting partners during the negotiation process.[156] It becomes vitally important, therefore, for parties to signal their willingness and ability to foster trust.

The problem with trust as a mechanism for developing cooperation is that it presents negotiators with a mixed-motive puzzle. Both parties benefit by trusting each other, but each party suffers if its trust is abused.[157] The situation faced by negotiators wanting to build trust, therefore, is essentially a "prisoner's dilemma."[158] This dilemma is illustrated by reference to the following hypothetical matrix of choices and payoffs faced by negotiators *A* and *B* as they square off across the bargaining table.[159]

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156. R. Lewicki & L. Litterer, *supra* note 51, at 111 (stating that mutually beneficial, integrative bargaining is fostered by the elimination of mistrust as a destructive factor in the bargaining process); Luhmann, *Familiarity, Confidence, Trust: Problems and Alternatives*, in Cooperative Relations, *supra* note 8, at 104 (arguing that a "*lack of trust* . . . reduces the range of possibilities for rational action" and "prevents, above all, capital investment under conditions of uncertainty and risk"); Pagden, *The Destruction of Trust and Its Economic Consequences in the Case of Eighteenth Century Naples*, in Cooperative Relations, *supra* note 8, at 130 (stating that "[e]conomic transactions are clearly more heavily dependent on agencies of trust than any other").

157. Morton Deutsch has defined trust precisely in these terms:

> We define "trust" as follows: *An individual may be said to have trust in the occurrence of an event if he expects its occurrence and his expectation leads to behavior which he perceives to have greater negative motivational consequences if the expectation is not confirmed than positive motivational consequences if it is confirmed.*

Deutsch, *Trust and Suspicion*, 2 J. Conflict Resolution 265, 266 (1958) (emphasis in original). He uses the example of hiring a baby sitter. If one's trust in the baby sitter is confirmed, the most one can expect is a pleasant evening out of the house. If one's trust is abused, harm may come to the baby. *Id.*

158. The prisoner's dilemma has evolved into one of the most powerful analytic tools in social science for the investigation of problems of human cooperation. *See* R. Axelrod, The Evolution of Cooperation 28 (1984) (asserting that "[t]he iterated Prisoner's Dilemma has become the *E. coli* of social psychology"); M. Deutsch, *supra* note 14, at 208; R. Lewicki & L. Litterer, *supra* note 51, at 35. The name "prisoner's dilemma" comes from the original story used to illustrate the paradox of cooperation. The story depicted two prisoners charged with the same crime but held in different cells. Police investigators approached each prisoner with the same two choices: Confess or remain silent. If one prisoner confessed and the other remained silent, the confessing prisoner could go free and the silent prisoner would be sentenced to five years imprisonment based on the testimony of the confessing prisoner. If both confessed, they each would receive a three-year sentence. If both remained silent, they each would receive a one-year sentence. The dilemma arises because neither prisoner knows what choice the other prisoner will make. If prisoner *A* remains silent, he may receive the worst result—five years in jail. Yet confession may bring a higher jail term than if both remain silent. Thus, the safest choice is confession, but the prisoners both will he better off if they can trust each other to remain silent. *See, e.g.*, Scott, *supra* note 43, at 2022 n.50. Professors Lax and Sebenius have noted that, as a business deal evolves, negotiators repeatedly face a "negotiator's dilemma" in selecting communication strategies and tactics. D. Lax & J. Sebenius, *supra* note 62, at 29-45. It is in the parties' mutual interests to engage in cooperative, trusting behavior. At the same time, however, it is in each party's individual interest to distort information and exploit vulnerabilities. *Id.*

159. This matrix is taken from D. Pruitt, *supra* note 14, at 107. The values assigned to the payoffs, while not empirical, do serve to illustrate, holding other factors constant, the relative advantages and disadvantages of various actions with respect to the degree of trust.

		A's Choice	
		Trust	Mistrust
B's Choice	Trust	12 12	17 1
	Mistrust	1 17	6 6

The upper left quadrant, in which both parties trust and take risks, yields a payoff of 12 to each negotiator and a total of 24 for the whole transaction. If only one party trusts, the total payoff drops to 18 because the efficiency and candor of a mutually trusting bargaining exchange remain untapped. The suspicious party, however, having withheld its cooperation, may seek to capture as many as 17 of the 18 payoff points by exploiting the other side's trust. If neither party trusts the other, they have a payoff of only 12 to divide at 6 each.

Faced with these choices, *A* may choose to trust *B*. Consequently, *A* may reveal information or commit resources. *A*'s trust will increase the surplus available to both parties, but it exposes *A* to exploitation by *B*. On the other hand, *A* may choose to distrust *B*. This orientation will yield dramatic benefits to *A* if *B* trusts and *A* is willing to exploit that trust.[160]

Because both sides realize that their trust is subject to exploitation, however, both parties likely will choose to mistrust. This scenario guarantees each party a yield of 6 and a chance at 17. The mutual election to distrust reduces the size of the joint surplus to its lowest point and thereby limits the possible gains from trade for both sides.

The negotiator's goal is to overcome the barriers that force the parties to act suspiciously, which will permit the better choice of mutual trust and cooperation.[161] The processes by which negotiators build trust

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160. Party *A* may not be willing to exploit *B*'s trust out of a concern for ethics, reputation, or some other principle. The problem is that *B* cannot be certain of *A*'s trustworthiness. To clear this hurdle, *A* must find ways to communicate credibly to *B* that it is trustworthy. If both sides can signal successfully their trustworthiness to each other, the mixed-motive puzzle is solved. The parties then can enjoy the mutually advantageous payoffs of the upper-left quadrant.

161. *See* Lindskold, *supra* note 145, at 772. The article asserts that "[b]asic to cooperation is the trust of the other party. . . . If the other party could only be trusted to be cooperative in search of the mutually beneficial solution, then the cycle [of distrust and competition] could be reversed, and both parties could gain rather than lose." *Id.*

are, thus, crucial to the success of many commercial relationships and the economic well-being of society as a whole.

B. *The Process of Building Mutual Trust*

There is no patented method of building trust.[162] Situational[163] and personality[164] variables both play a part in setting the conditions for establishing trust.[165] Similarity of backgrounds and tastes also helps smooth the way to trusting relations.[166]

Regardless of the factors facilitating trust, however, unilateral, transaction-specific investments are important signals in the process of building and maintaining trusting relationships.[167] The mixed-motive

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162. R. LEWICKI & L. LITTERER, *supra* note 51, at 111 (stating that "[g]enerating trust is a complex, uncertain process").

163. Trust may arise spontaneously from unusual situations in which people are forced by circumstances to cooperate with one another. Gambetta, *supra* note 152, at 225-27. Once trust is developed, it may persist after the crisis has passed. *Id.*

164. Psychologists have determined that some people have "high-trust" personalities—they are willing to give people the benefit of the doubt until they are proven wrong. R. LEWICKI & L. LITTERER, *supra* note 51, at 270-72; Rotter, *A New Scale for the Measurement of Interpersonal Trust*, 35 J. PERSONALITY 651 (1967). "Low-trust" personality types take the opposite view and treat others with suspicion until they prove to be trustworthy. Rotter, *supra*, at 651. Moral or religious feelings are also possible sources of trust. Gambetta, *supra* note 152, at 231.

165. Situational factors appear to have slightly more influence than personality in determining the level of cooperation between people. Terhune, *The Effects of Personality in Cooperation and Conflict*, in THE STRUCTURE OF CONFLICT 218 (P. Swingle ed. 1970).

166. R. LEWICKI & L. LITTERER, *supra* note 51, at 112 (asserting that trust is enhanced by similarity of background).

167. N. LUHMANN, *supra* note 15, at 24 (formulating the problem of trust as "a gamble, a risky investment"); Lillibridge & Lundstedt, *Some Initial Evidence for an Interpersonal Risk Theory*, 66 J. PSYCHOLOGY 119, 120 (1967) (arguing that risky behavior supports maintenance or enhancement of trust); Lindskold, *supra* note 145, at 789 (stating that psychological "attribution principles" suggest that "voluntarily risking vulnerability and being open and consistent will promote the attribution of trustworthiness"); Lundstedt, *Interpersonal Risk Theory*, 62 J. PSYCHOLOGY 3 (1966) (discussing how the willingness to give away influence and control can foster trusting relationships); Swinth, *The Establishment of the Trust Relationship*, 11 J. CONFLICT RESOLUTION 335 (1967) (discussing empirical support for the mechanism of initiating trust through taking unilateral, risk-exposing steps). Research from a variety of sources reinforces the conclusion stated in this Article. The "tit-for-tat" strategy for playing the iterated prisoner's dilemma is one of the most consistently successful methods of achieving high cooperation in mixed-motive situations. R. AXELROD, *supra* note 158, at 27-54. A crucial part of the strategy is a willingness to make a cooperative first move and, therefore, risk exploitation during initial interaction with the opposition. *Id.* at 113-17 (discussing the "never be the first to defect" rule); Gambetta, *supra* note 152, at 227 (asserting that "when the game has no history, a cooperative first move is essential to set it on the right track"; such a move requires a "predisposition to trust"). Once this trustworthiness is shown in the first interaction, the tit-for-tat strategy simply mimics the other party's behavior in the preceding period. R. AXELROD, *supra* note 158, at 31. The model of unilateral risk taking to build trust also is supported by Professor Charles Osgood's Graduated and Reciprocated Initiatives in Tension Reduction (GRIT) strategy for resolving international conflicts. C. OSGOOD, AN ALTERNATIVE TO WAR OR SURRENDER 85-134 (1962). Central features of the GRIT proposal are the unilateral announcement and execution of tension-reducing initiatives and the continuation of these initiatives even when they are not reciprocated. R. LEWICKI & L. LITTERER, *supra* note 51, at 283-85;

nature of most commercial exchanges makes it difficult to convince the other side that one can be trusted to act cooperatively.[168] The risk inherent in making a precontractual investment is a powerful way to signal one's trustworthiness and commitment to a cooperative regime.[169] This committal reassures others who are naturally suspicious of one's intentions. In addition, precontractual investments indicate that the investor is prepared to trust the other side. Finally, investments may instill a sense of obligation in the other party to reciprocate trust, thus setting in motion a cycle of mutually beneficial trusting acts.[170]

Professor Dean Pruitt has described several actions that negotiating parties use as signals that they either are trustworthy or willing to trust the other party.[171] Relatively low-risk steps include attempts to

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Lindskold, *supra* note 145, at 775-77. The GRIT strategy has been proven an effective means of inducing trust. Lindskold, *supra* note 145, at 777; Lindskold & Collins, *Inducing Cooperation by Groups and Individuals*, 22 J. CONFLICT RESOLUTION 679, 680, 688 (1978); Lindskold & Finch, *Styles of Announcing Conciliation*, 25 J. CONFLICT RESOLUTION 145, 147 (1981) (noting that "[t]he experimental support for the GRIT proposal is substantial" and that GRIT "presents a model against which communication patterns can be compared for their effectiveness in inducing trust in conflict").

168. *See supra* notes 144-45 and accompanying text.

169. R. LEWICKI & L. LITTERER, *supra* note 51, at 112 (suggesting that "we are more likely to trust people who initiate cooperative, trust behavior"); D. PRUITT, *supra* note 14, at 124-31 (arguing that trust can be built during bargaining by taking various kinds of risks); Golembiewski & McConkie, *supra* note 14, at 140 (stating that while there is no solid empirical justification for concluding that "risk and trust are high, direct covariants," there is "no question that trust can be increased by substantial risk-taking behavior").

170. Many people adhere to a deeply felt norm of reciprocity. In other words, "the mere fact that someone has placed his trust in us makes us feel obligated, and this makes it harder to betray that trust." Dasgupta, *Trust As a Commodity*, in COOPERATIVE RELATIONS, *supra* note 8, at 49, 53; *see also* R. LEWICKI & L. LITTERER, *supra* note 51, at 195-96 (recounting a Nigerian commercial custom in which shopkeepers give customers a small gift upon entering to trigger the "universal norm of reciprocity"); Gambetta, *supra* note 152, at 234 (agreeing that "the concession of trust . . . can generate the very behavior which might logically seem to be its precondition"). These patterns of trust development exist not only in business dealings but also in basic social relations. Haas & Deseran, *Trust and Symbolic Exchange*, 44 SOC. SCI. Q. 3, 4 (1981) (asserting that "trust is necessary in any relationship, although the amount of trust required may vary with the nature of the relationship"). In the personal realm, trusting relations grow through a series of "gradually increasing investments in the relationship, a series in which the partners can demonstrate their trustworthiness to each other." *Id.* at 3; *see* W. BENNIS, E. SCHEIN, F. STEELE & D. BERLEW, INTERPERSONAL DYNAMICS: ESSAYS AND READINGS ON HUMAN INTERACTION 217 (1964) (noting that people build trust by exposing more and more of their "selves" to each other, thus creating a mutually reinforcing pattern, because "when one person trusts enough to make himself vulnerable by exposing himself, trust is generated in the other person"); P. BLAU, EXCHANGE AND POWER IN SOCIAL LIFE 98 (1964). Clearly, business and social relations may be quite different. For example, the explicit nature of reciprocal actions in a commercial relationship may not fit in a personal relation in which "the authenticity and value of social approval or other nonmaterial rewards depend heavily on their *not* being provided simply as an inducement for some other reward." D. JOHNSON, SOCIOLOGICAL THEORY 363 (1981) (emphasis in original); Gambetta, *supra* note 152, at 231 (arguing that "[i]f X detects instrumentality behind my manifestations of friendship, he is more likely to reject me and, if anything, trust me even less").

171. Pruitt categorizes these actions as low-, moderate-, and high-risk steps. D. PRUITT, *supra*

form social or quasi-social relationships through demonstrations that the parties share similar backgrounds and interests.[172] As noted earlier, similarity of backgrounds and tastes enhances the conditions for trust.[173] These social relations frequently are marked by symbolic, unilateral "investments," such as gifts and exchanges of food or drink.[174] Another low-risk step is the use of deliberate signals at the bargaining table that enable parties to suggest possible areas of compromise and flexibility without committing the signaler to any particular concession.[175] These low-risk behaviors preserve negotiators' bargaining positions, while enabling them to test the other side's willingness to engage in a reciprocal relationship.[176]

High-risk behavior differs both in style and effect from low-risk conduct. Examples of high-risk coordinative moves include large concessions, unilateral, tension-reducing actions, statements regarding motive,[177] and any other step that puts the negotiator at clear risk of loss.[178] These steps risk loss of reputation, bargaining position, informa-

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note 14, at 92. For purposes of the discussion, this Article combines Pruitt's low- and moderate-risk actions into a single "low-risk" category.

172. Lorenz, *supra* note 8, at 207-08 (stating that business people tend to create through "personal contact" an intermediate level of human relationship somewhere "between friend and stranger, for which capitalist societies have developed a distinctive tolerance").

173. *See supra* note 166 and accompanying text. Business parties often make investments in indirect signals of similarity by joining clubs, associations, and other networks. Membership in these groups signals a set of underlying backgrounds and interests that help to foster trust in certain encounters in the bargaining arena. Gambetta, *supra* note 152, at 232.

174. Haas & Deseran, *supra* note 170, at 4, 7-9 (noting that personal relationships of trust often involve symbolic exchanges of food and drink, gifts, love tokens, attendance at formal ceremonies, and visits).

175. D. PRUITT, *supra* note 14, at 93-99. For example, parties unwilling to make outright concessions out of fear of being exploited may signal their willingness to concede by remaining curiously silent when the other party makes a proposal incorporating that concession. *Id.* at 94. To be successful, the signal "must be *noticeable*, that is, stand out as figure against ground, and yet be *disavowable* if it does not produce a coordinative response." *Id.* These signals are risky because they communicate information regarding the sender's flexibility and expose the sender to the possibility of nonreciprocation. *Id.*

176. During the beginning stages of bargaining, initial tests of reciprocity include negotiators' revealing of "specific information about themselves, their needs, or their resources. If the relationship is to survive this stage, intimate disclosure must be reciprocated." Dwyer, Schurr & Oh, *supra* note 14, at 16.

177. Sincere statements that one is ready to trust the other side are in the high-risk category and can enhance the chances for cooperation. Research has shown that people respond to direct communications by others who propose a cooperative relationship as an alternative to mutually disadvantageous competition. Deutsch, *supra* note 157, at 275 (noting that "it is evident that mutual trust can be established in people with an individualistic orientation through communication"). The development of trust is enhanced considerably if the proposal to cooperate is announced as a unilateral decision grounded in stated reasons rather than presented in a cautious, "I will if you will" fashion. Lindskold & Finch, *supra* note 167, at 153.

178. D. PRUITT, *supra* note 14, at 94.

tion, and future opportunities to resume a hard bargaining stance.[179]

Business parties may build trust through unilateral risk-taking either by gradually increasing the level of risk[180] or by moving directly to high-risk steps if warranted by the circumstances.[181] The sequential give-and-take of many negotiations makes reciprocation of low-risk steps obvious and express, thus enhancing the likelihood of constructing a successful relationship.[182] Parties unwilling to engage in even tentative, low-risk reciprocal exchanges discourage progression to riskier forms of conciliatory, cooperative action. If the parties establish a degree of trust, however, a "lock-in" effect emerges that maintains the momentum of cooperation throughout the course of the relationship.[183]

For parties to reap the rewards of cooperation, they somehow must progress to the level of high-risk steps. First, low-risk moves take parties only part of the distance toward establishing trust because their

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179. *Id.* at 92.

180. The parties would begin by reciprocating low-risk steps and progress to higher levels of risk. *See* Dasgupta, *supra* note 170, at 64-66 (discussing the need for repeated encounters to develop trust); Dwyer, Schurr & Oh, *supra* note 14, at 16-24. The Dwyer article presents a model of the stages in business relationships: (1) awareness, (2) exploration, (3) expansion, (4) commitment, and (5) dissolution. The exploration stage permits parties to gather experiences of one another before deciding to move to the expansion and commitment stages. Dwyer, Schurr & Oh, *supra* note 14, at 16-24.

181. Some commercial situations demand high-risk moves without allowing the luxury of a gradual trust-building process. The construction project bidding process is an example. *See supra* notes 115-24 and accompanying text. The actual mechanism for establishing a trusting relationship—the sequence of risk-taking steps needed to overcome the mixed-motive dilemma—can take two forms. Swinth, *supra* note 167, at 336-37. Both mechanisms, however, call for an initial move by one party that will expose it to risk. *Id.* One mechanism calls for the initiator to take a step that exposes him to a risk of loss. If the responding person can forego a personal gain and also save the trust initiator from incurring its loss, the cycle of trust building is complete and "a degree of trust" is established. *Id.* at 336. If the situation does not permit parties to forego personal gains, a four-step procedure will produce the same result. First, the initiator exposes itself to a risk of loss. Second, the responding party acknowledges that step but takes no action to profit by it. Third, the responding party exposes itself to a risk of loss. Finally, the initiator takes no advantage of the responding party. *Id.* at 336-37. Swinth tested these models experimentally and confirmed both procedures. *Id.* at 343.

182. Brickman, Becker & Castle, *Making Trust Easier and Harder Through Two Forms of Sequential Interaction*, 37 J. PERSONALITY & SOC. PSYCHOLOGY 515, 520 (1979) (showing that in an experiment with males, a much higher degree of cooperation was achieved in a game involving alternating choices than in one involving simultaneous choices); Dwyer, Schurr & Oh, *supra* note 14, at 16 (asserting that "[t]hrough questions and answers, buyers and sellers develop a process of taking turns, making interaction easier"); Hake & Schmid, *Acquisition and Maintenance of Trusting Behavior*, 35 J. EXPERIMENTAL ANALYSIS BEHAV. 109, 121 (1981); Schmid & Hake, *Fast Acquisition of Cooperation and Trust: A Two-Stage View of Trusting Behavior*, 40 J. EXPERIMENTAL ANALYSIS BEHAV. 179, 179 (1983).

183. M. DEUTSCH, *supra* note 14, at 30-31 (stating that both competition and cooperation tend to be self-confirming); R. LEWICKI & L. LITTERER, *supra* note 51, at 113 (discussing the "lock-in" effects of cooperation); J. RUBIN & B. BROWN, *supra* note 51, at 265 (discussing "lock-in" effects).

low cost renders them easily faked and, hence, less credible.[184] Steps that subject a party to substantial loss are more convincing and, therefore, can form the basis for a more stable and productive relationship.[185] Second, high-risk steps move the parties beyond mere coordination of a zero-sum, distributive bargaining regime to a truly cooperative relationship in which they are able to create, not merely divide, economic value from their interaction.

The cases examined in Part II illustrate the importance of high-risk steps in the process of trust development and the consequences that occur when the trust-building process is cut short by opportunistic behavior. For example, in *Smith v. Dravo Corp.*[186] the buyer, Union, entered into negotiation by professing an interest in purchasing only a few container units. Upon learning that the seller was eager to sell, however, Union expanded the negotiation to include the entire container business. Union then requested generous information disclosure ostensibly to price its bid adequately.

The *Dravo Corp.* opinion does not recount the initial steps that the parties took to establish a trusting relationship. The rapid expansion of the deal, however, suggests that a highly cooperative tone dominated early communications. Had the seller been reluctant to reveal information under the circumstances, its reticence may have put the negotiations back on a competitive footing disadvantageous to both sides. Thus, the seller opted to make a series of unilateral, high-risk moves. At Union's request, the seller revealed its patent application, product files, and a working model of the container. Next, it led Union on a tour of its plant. When Union had all the information it needed, the seller

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184. At the low-risk level, "conventional [trust-inducing] gestures can be counterfeited." Haas & Deseran, *supra* note 170, at 5; *see* Lindskold & Finch, *supra* note 167, at 153-54 (remarking that "inferences drawn about the characteristics of an actor from his or her actions will be made more confidently if the actions are risky and potentially costly to the actor"). Trust is a disposition attributed by others. Psychologists have developed two principles—the augmentation principle and the "discounting" principle—that explain when attributions are likely to be strong or weak. *See* K. SHAVER, THE ATTRIBUTION OF BLAME 54 (1985) (discussing discounting and augmentation principles); Kelly, *The Processes of Causal Attribution*, 28 AM. PSYCHOLOGIST 107, 113-14 (1973). The augmentation principle holds that "a person's act will be viewed as expressive of his true dispositions if the act involves risk of loss or actual costs." Lindskold, *supra* note 145, at 774. Thus, if people are truthful when it hurts them to be so, others more likely will think they are genuinely truthful people. It follows that costly bargaining signals will be viewed more credibly than those costing less. The augmentation principle is offset by the discounting principle, which states that acts will be viewed as less expressive of people's true disposition if there are "apparent external causes" for them. *Id.* The literature on economic "signaling" supports this notion in that signals are more credible when they are costly or difficult to fake. R. FRANK, *supra* note 16, at 99.

185. Dasgupta, *supra* note 170, at 70 (suggesting that truly trustworthy people must spend extra resources to distinguish themselves from people who are trying merely to imitate the appearance of trustworthiness).

186. 203 F.2d 369 (7th Cir. 1953).

then made several substantial price concessions. In response, Union exploited the seller's trust by breaking off discussions and using the seller's design information to build a similar, competing container unit.[187]

Hoffman v. Red Owl Stores,[188] *Channel Home Centers v. Grossman*,[189] and *Gadsden Paper & Supply Co. v. Washburn*[190] display more subtle forms of opportunism. In all of these cases, various conciliatory announcements induced plaintiffs to invest transaction-specific resources. The plaintiffs believed that the investments would serve not only their own interests but the interests of the overall commercial relationship as well. These steps represented the most credible type of high-risk signals, indicating the parties' readiness to cooperate and save considerable resources for both sides.

In *Hoffman*[191] the plaintiff undertook costly steps to leave his old profession and train himself as a grocer. These investments would have benefited both the franchisee and the franchisor had the deal gone through. The franchisor's response to each of these signals was encouraging. Through this series of nibbles, the franchisor convinced Hoffman to commit to the deal.[192] It then attempted to appropriate a greater share of the bargaining surplus by raising the amount of the capital investment required and demanding that Hoffman's father contribute to the enterprise by way of a substantial gift.

In *Channel Home Centers*[193] the inducement appeared in a letter of intent that promised the prospective tenant (Channel) that the landlord would "negotiate . . . to completion" the shopping center rental agreement.[194] Channel's site improvement investments were for the mutual benefit of the parties, and the parties' ability to coordinate in the absence of a binding lease foretold a very cooperative relationship for

187. *Id.* at 372-73. Skycom Corp. v. Telstar Corp., 813 F.2d 810 (7th Cir. 1987), exhibited the same pattern. During negotiations to sell his company, the seller in *Skycom* was persuaded to turn over a valuable asset. When this asset was safely in the buyer's hands, the buyer simply declined to go forward with the deal. *Id.* at 812-13; *see supra* notes 82-84 and accompanying text.

188. 26 Wis. 2d 683, 133 N.W.2d 267 (1965).

189. 795 F.2d 291 (3d Cir. 1986).

190. 554 So. 2d 983 (Ala. 1989).

191. *See supra* notes 85-87 and accompanying text.

192. *See supra* note 79 and accompanying text. Professor Mark Gergen recently has argued that *Hoffman* should be thought of as a case of negligent misrepresentation or mistake, rather than a case of breached promise. *See* Gergen, *supra* note 10, at 2-3, 31-40. Even if Red Owl were simply careless in its representations, however, its acts were opportunistic in that they caused Hoffman to invest transaction-specific assets to further Red Owl's interests as a future supplier and creditor of Hoffman and as a condition of entering a binding contract. *Id.* at 32-33 n.153 (noting that Red Owl admitted at trial that its added conditions were designed to enhance its credit position). My own view is that, at best, Red Owl acted recklessly in this regard.

193. *See supra* notes 94-96 and accompanying text.

194. *Channel Home Centers*, 795 F.2d at 293.

the future. When the landlord walked away from the agreement and rented to a higher paying tenant, it violated an implicit, but material, term of this relationship—the trust Channel exhibited by investing heavily before a contract was signed.

In *Gadsden Paper*[195] the plaintiff turned over his only valuable asset—his customers—in a transaction that he presumed to be the sale of his business. The buyer offered a cooperative signal: both parties would save transaction costs if the deal were structured as an at-will employment arrangement instead of a sale of assets. The seller trusted this signal and reciprocated by foregoing alternative contractual protections. Thus the plaintiff increased the potential value of the transaction to both parties. At the same time he unfortunately exposed himself to a risk of loss. The buyer subsequently seized on the seller's cooperation as an opportunity to acquire the seller's business without paying.

Drennan v. Star Paving Co.[196] and *Collins v. Philadelphia Oil Co.*[197] provide a third variation on the theme of trust and opportunistic conduct. In these two cases the parties did not engage in sequential exchanges that ultimately led to high-risk cooperative moves. Rather, the structure of the transaction pushed the plaintiffs to commit resources before important segments of the transaction under the defendants' control had become final. The initial price agreements in both *Star Paving* and *Collins* suggest that the parties had concluded a definite stage of the coordination process and that the matter of price was settled, even if the contracts were not. With no signs of a competitive regime in which each party was expected to erect a full set of transactional defenses to guarantee reciprocal trust, the parties were justified in taking high-risk actions with the assurance that they would not be ambushed. After the plaintiffs relied on the price agreement by setting up a dependent transaction, however, the defendants opportunistically sought to usurp the profits from the second transactions by demanding a new price in the underlying deal. These actions directly abused the trust needed to form linked business arrangements in a complex economy.

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195. *See supra* notes 111-14 and accompanying text.

196. 51 Cal. 2d 409, 333 P.2d 757 (1958); *see supra* notes 120-22 and accompanying text. Because prime contractors usually are committed to the terms of their bid as soon as they submit them, *see supra* note 124 and accompanying text, it seems sensible to place the risk of mistaken subcontractor bids on the party that is best able to prevent such mistakes—subcontractors—even in the period between bid submissions and final contract award. *See* Gergen, *supra* note 10, at 2. The danger of opportunism posed by postaward subcontractor bid withdrawals provides an additional, compelling justification for making subcontractors liable.

197. 97 W. Va. 464, 125 S.E. 223 (1924); *see supra* notes 129-31 and accompanying text.

IV. The Role of Law in Supporting Trust: Toward a New Cause of Action

A. *The Role of Law in Supporting Trust*

Making unilateral, conciliatory moves in negotiation, while arguably necessary to induce trust in some circumstances, does not guarantee a mutually trusting, reliable relationship. To sustain trust and enhance the chances for reciprocity, parties also must be willing and able to deter those who might act opportunistically after a trusting relationship is underway.[198] Research has shown that people who cooperate unconditionally do not induce cooperative responses as frequently as those who are conditionally cooperative—cooperative but willing to retaliate if their trust is abused.[199] Therefore, there is a need to devise mechanisms that deter people who are tempted to violate trust.

Legal recourse for victims of opportunistic conduct is one possible remedy for bolstering the cooperative process.[200] There are substantial

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198. It pays for the opportunist to pretend to be trustworthy for a number of interactions with the potential victim to induce the belief that he is trustworthy. *See* R. Frank, *supra* note 16, at 16. The trick for the opportunist is to induce the maximum degree of high-risk trusting behavior in the other side with the minimum degree of low-risk exposure to himself. The opportunist thus remains sufficiently behind the other side in his investment, which makes opportunism profitable. As the investments by the opponent mount, the rewards of opportunistic behavior increase. Finally, rewards reach a point at which betrayal of the other's trust becomes attractive regardless of offsetting concerns for moral worthiness or business reputation. Sobel, *A Theory of Credibility*, 52 Rev. Econ. Stud. 557, 570 (1985).

199. *See* R. Axelrod, *supra* note 158, at 118, 136 (noting that the tit-for-tat strategy requires reciprocation of "both cooperation and defection" and "turning the other cheek provides an incentive for the other player to exploit you"); M. Deutsch, *supra* note 14, at 199-200, 332-37 (finding that subjects behaved most cooperatively in experiment in which the opponents played the strategy of being conditionally cooperative and adopted a policy of protecting themselves from exploitation by using measured, reliable responses when the subject abused trust); Gruder & Duslak, *Elicitation of Cooperation by Retaliatory and Nonretaliatory Strategies in a Mixed-Motive Game*, 17 J. Conflict Resolution 162, 171 (1973) (confirming effectiveness of inducing cooperation by nonpunitive response strategy). An important part of the GRIT proposal, *see supra* note 167, also is a willingness to retaliate when trnst is abused. Retaliation, however, must be measured to nullify the opponent's gains from defection rather than to impose positive costs. Lindskold, *supra* note 145, at 789.

200. The threat of state-imposed legal sanctions provides the external motivation needed to spur essentially egoistic opportunists to weigh the costs of their actions on others. Williams, *Formal Structure and Social Reality*, in Cooperative Relations, *supra* note 8, at 6, 10 (agreeing that the threat of legal sanctions provides "egoistic macro-motivation" to induce cooperation). The possibility of legal sanctions also encourages parties who are uncertain about whether to trust. *See* N. Luhmann, *supra* note 15, at 36 (stating that legal "sanctions in the event of breach of trust offer some support to someone considering whether to trust" even if the other party has no knowledge of such sanctious). Given that opportunists are hard to identify, *infra* notes 203-07 and accompanying text, and that even people who want to trust and cooperate are deterred from doing so by the structure of mixed-motive situations, *supra* notes 144-45 and accompanying text, "even parties with sharply conflicting interests and values may all prefer a set of rules and institutional arrangements regulating the game of coordination . . . to deal with problems of trust" Heymann, *supra* note 18, at 830. *But see* Charny, *supra* note 47, at 441, 442 (arguing that "conceptions of trust do

risks, however, associated with legal intervention in the bargaining process. First, nonlegal deterrents such as reputational sanctions may provide adequate protection at much less cost than legal redress. Second, legal remedies are rather blunt instruments that often cause unanticipated and unwanted consequences. Legal rules can create incentives for unscrupulous plaintiffs to bring groundless claims. Fear of such behavior may cause some parties to forego bargaining. In addition, inefficient legal rules add cost to the bargaining process because parties must bargain around their effect. Finally, legal compensation takes some of the risk out of making high-risk moves through transaction-specific investments, thereby dampening their effectiveness as trust-related signals. Before endorsing the legal regnlation of bargaining opportunism, therefore, one must examine whether the costs of intervention outweigh the benefits of legal sanctions in the deterrence of precontractual opportunism.

1. Nonlegal Mechanisms to Deter Opportunism

A number of nonlegal, market mechanisms limit bargaining opportunism.[201] One defensive mechanism is human perception. If people reliably could identify opportunists simply through communication and interaction with them, legal sanctions would not be needed. Parties seeking trusting business relationships would know when they were dealing with opportunists, avoid them when possible, and charge them more for deals when they are unavoidable.[202]

One commentator recently has argued that people effectively can discern whom to trust.[203] Research indicates, however, that this is a rare skill. For example, when people tell lies, their focus on maintaining an appearance of truthfulness in their facial expression causes their hands

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not provide plausible grounds for regulation" and that "widespread enforcement of informal commitments based on trust alone would create a dystopia of regulatory oppression").

201. Indeed, some commentators have argued that the market is fully capable of eliminating opportunism. *See* Hill, *Cooperation, Opportunism, and the Invisible Hand: Implications for Transaction Cost Theory*, 15 ACAD. MGMT. REV. 500, 511-12 (1990) (arguing that "when the state of competitive equilibrium is reached the population of economic actors will contain only those whose behavioral repertoires are biased toward cooperation," and that "the construction of a long-term relationship based around cooperation and trust is [the] optimal [business arrangement]"). Other commentators disagree, arguing that "over the long term, low trust and competition 'drive out' high trust and cooperation." R. LEWICKI & L. LITTERER, *supra* note 51, at 272. A third position, which perhaps comports best with most people's experience, is that there is an ecological balance between opportunism and trustworthiness, and that sufficient incentives and rewards exist to perpetuate both types of behavior. R. FRANK, *supra* note 16, at 11, 94-95, 254-55.

202. For example, Donald Trump claims to be "blessed with a kind of intuition that allows me to sense who the sleazy guys are, and I stay far away from them." D. TRUMP, TRUMP: SURVIVING AT THE TOP 39 (1990) (discussing how Trump avoided dealing with Ivan Boesky).

203. *See* R. FRANK, *supra* note 16, at 134-35.

to display fewer than normal illustrator movements.[204] Because everyone has a different amount of normal hand movement, however, this indicator is difficult to use without knowing the liar extremely well. A leading empirical scholar on lying and human perception has concluded that "[f]ew people do better than chance in judging whether someone is lying or truthful."[205] More alarmingly, a few people have an extraordinary ability to control the emotional cues that communicate to others that they are lying.[206] Even the most skilled observers have trouble detecting when these people are being deceptive.[207] Hence, although some opportunists may be unmasked occasionally, human perception overall is not a reliable defense to opportunistic behavior.

A second mechanism to combat opportunism is the integration of firms. Opportunism generally is less likely to occur in transactions within organizations than in negotiations between different entities.[208] Intraorganizational transactions are safer because of the strong social constraints and sanctions against deceit that exist among people who work together. Monitoring behavior within firms also is more effective than between firms.[209] Thus, one reason firms switch from market transactions to internal transactions is to reduce transaction costs by controlling opportunistic behavior.[210]

Firm integration realistically cannot serve as a broad deterrent against opportunism. The costs of integration are high relative to many forms of opportunism. Not all firms have sufficient resources to integrate with others vital to their line of business. Finally, even integrated firms cannot eliminate opportunism completely because they must deal with suppliers and customers.[211]

The third and perhaps most potent nonlegal deterrent to opportunistic behavior is the fear of developing a bad reputation as a business partner. The "reputation effect" is well documented in business research as contributing significantly to the stability of long-term com-

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204. *Id.* at 131.

205. P. EKMAN, *supra* note 126, at 162.

206. Others may he so prone to self-deception that they will not appear deceptive because they will have convinced themselves they are telling the truth. R. FRANK, *supra* note 16, at 131-33. Professor Paul Ekman has suggested that effective liars are especially well suited for careers as negotiators. *See* P. EKMAN, *supra* note 126, at 56-57.

207. P. EKMAN, *supra* note 126, at 57. Interestingly, one of Ekman's studies was conducted with nursing students. The students who were the best liars also did exceptionally well in their nursing training. Ekman attributed this to their ability to control their emotions. *Id.* at 59.

208. Provan & Skinner, *Interorganizational Dependence and Control As Predictors of Opportunism in Dealer-Supplier Relations*, 32 ACAD. MGMT. J. 202, 203 (1989).

209. *Id.*

210. O. WILLIAMSON, *supra* note 25, at 85-130; Provan & Skinner, *supra* note 208, at 203-04.

211. Provan & Skinner, *supra* note 208, at 204.

mercial relationships.[212] The reputation effect has at least two dimensions, but neither appears strong enough to deter bargaining opportunism effectively in all commercial circumstances.[213]

The first dimension of the reputation effect is that parties will seek to maintain reliability and trustworthiness within the context of a particular commercial relationship. Thus, parties that anticipate repeated dealings with one another have strong incentives to establish and maintain trust as a means of cutting costs over the long run.[214] These incentives, however, suffer from a number of weaknesses when considered in the negotiation context. First, empirical evidence suggests that in the last twenty years commercial parties have become less concerned with the effects of their reputations with respect to particular business relationships. Professors Marc Galanter and Joel Rogers recently have asserted that the extremely competitive environment of American business practice beginning in the 1970s has made businesses, at least in the aggregate, more likely to discount the value of long-term relationships and to focus instead on the short-term gains that can be captured by competitive behavior.[215]

More importantly, reputational incentives have only limited force when parties are engaged in a one-shot transaction, or when one negotiating party either never intends to establish a relationship or intends for that relationship to be abusive. Parties in one-time transactions, like the deals in *Skycom* and *Dravo*, have limited reputational concerns toward the other party because the parties contemplate no future busi-

212. Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 618-21 (1984); Gordon, *supra* note 4, at 1549-50 (stating that "[t]o an economist, an implied contract is one that is enforced through marketplace mechanisms such as reputation effects rather than in a court, a means of enforcement that may not bring relief to the aggrieved party but will over time penalize parties who welsh"); Klein & Leffler, *The Role of Market Forces in Assuring Contractual Performance*, 89 J. POL. ECON. 615, 616 (1981); Telser, *A Theory of Self-Enforcing Contracts*, 53 J. BUS. 27, 28 (1980).

213. Heymann, *supra* note 18, at 821-23 (discussing concern for reputation within a particular relationship and within market as a whole and concluding that "if we had to rely on reputation alone, the benefits of coordination would escape us in a myriad of situations").

214. R. AXELROD, *supra* note 158, at 178 (arguing that business transactions are "based upon the idea that a continuing relationship allows cooperation to develop without the assistance of a central authority"); Klein & Leffler, *supra* note 212, at 616; Provan & Skinner, *supra* note 208, at 204 (noting that the incidence of opportunistic behavior "will probably be low when relations among organizations are long-term because of the expectation of repeat business").

215. *See* Galanter & Rogers, *A Transformation of American Business Disputing? Some Preliminary Observations* 62 (Institute for Legal Studies Working Paper No. DPRP 10-3) (1990) (discussing the possibility that the number of business disputes has increased and that these disputes are not handled well by " 'traditional' forms of private governance"); *see also* Friedman, *Opening the Time Capsule: A Progress Report on Studies of Courts Over Time*, 24 LAW & SOC'Y REV. 229, 235-36 (1990); Geyelin, *Feuding Firms Cram Courts, Study Says*, Wall St. J., Dec. 31, 1990, at 9, col. 4 (summarizing Galanter and Rogers study and stating that "long-term business relationships are no longer as important as they used to be").

ness dealings.[216]

Reputational sanctions also have limited effect on especially venal parties. Arguably, a defendant like that in *Gadsden Paper* enters negotiations solely to acquire property, not to establish a commercial relationship. In *Hoffman*, on the other hand, the franchisor's bargaining conduct clearly revealed its intention to dominate any future relationship and abuse the franchisee. Parties like those in *Gadsden Paper* and *Hoffman* will not be deterred by transaction-specific concerns for reputation either because, in their opinion, the rewards of opportunism outweigh the costs of losing future business with their opponents, or because a bargaining power imbalance leads them to discount relational, reputational concerns.

The second dimension of reputational concern that reduces opportunistic conduct is a business's reputation in the market as a whole. Building a general reputation for reliability and trustworthiness has benefits. Given the mixed-motive character of most business dealings,[217] negotiators likely will prefer to deal with trustworthy people rather than strangers or those known to be untrustworthy.[218] Put plainly, people who act opportunistically in bargaining situations reduce their chances of acquiring a good reputation and risk developing a distrustful reputation. In either case, their transaction costs are likely to rise, and their overall profitability will drop as others insist on dealing with them cautiously or not at all.

General concern for market reputation has the potential for deterring some bargaining opportunism. To be an effective deterrent, how-

216. Gordon, *Unfreezing Legal Reality: Critical Approaches to Law*, 15 FLA. ST. U.L. REV. 195, 208 (1987) (setting out the argument that "the legal system . . . should . . . underwrite relationships of trust, of general reciprocity, and penalize breaches of trust—*especially* in situations where the [commercial] relationship is not likely to be a continuing one, so that the sanction of refusing future dealings is unavailable"). Transaction-specific reputational incentives also suffer from what has been called a last-period problem. Muris, *supra* note 4, at 528. If one party knows it may terminate an existing long-term relationship and the other party is ignorant of this intention, the knowledgeable party can exploit the trust that has built up over the course of repeated interactions. The last-period problem is important when parties negotiate a series of discrete contracts between themselves over an extended period of time. *See* Greenstein v. Flatley, 19 Mass. App. Ct. 351, 474 N.E.2d 1130 (1985) (discussing lease renewal negotiations); Markov v. ABC Transfer & Storage Co., 76 Wash. 2d 388, 457 P.2d 535 (1969) (discussing lease renewal negotiations). Professor Narasimhan has explored this situation in detail. *See* Narasimhan, *Relationship or Boundary*, *supra* note 4, at 1077.

217. *See supra* notes 143-45 and accompanying text.

218. Opportunists would prefer to deal with trustworthy people because they are more easily exploited, at least in their initial interaction. Trustworthy people would prefer to deal with other trustworthy people so they can gain the benefits of cooperation. R. FRANK, *supra* note 16, at x (asserting that "we make every effort [in ventures that require trust] to exclude [self-interested people] in favor of others we believe to be honest"); *id.* at 54 (arguing that "[t]he potential gain . . . from being honest is to cooperate with others who are also honest"). In either case, a market reputation for trustworthiness attracts bargaining partners.

ever, information regarding a party's untrustworthiness must be transmitted efficiently throughout the market. Evidence suggests that reputational information is not disseminated as readily as one would hope.

First, ours is a highly mobile society in which it is possible to stay one step ahead of a bad reputation.[219] The costs of researching reputations is high both in absolute terms and in terms of the resources available to particular negotiators. Mr. Hoffman, for example, likely had minimal resources to devote to extensive research into Red Owl's negotiating tactics. Nor would extensive research necessarily provide a definitive return. Hoffman probably was forced to rely on his own judgment based on his initial experiences of negotiating with Red Owl.

Second, reputational facts, if known, are subject to multiple interpretations. For example, large organizations often can explain to prospective business partners that a particular instance of opportunism was caused by a corporate agent who no longer influences decisions or who exceeded company policies.[220] Thus, reputation researchers never can eliminate their uncertainty about parties with whom they deal.[221] This lack of clear return on reputation research no doubt causes firms to forego extensive reputation checks.[222]

The advent of nationwide computerized legal research offers an ef-

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219. *Id.* at 112 (noting that in earlier times stable communities encouraged investment in reputation, and strangers were viewed with some suspicion, whereas "[i]n the current environment, where mobility is very high, the opportunist [is] attracted to the strategy of moving to a new location each time he [gets] caught cheating" because the mere fact that he is a stranger carries no negative presumption). Mobility also lowers the returns of investing resources in creating and maintaining a good reputation because strangers are more likely than friends to assume the worst about someone and act accordingly. There is evidence of a general decline in trusting behavior in the past 30 years caused in part by "fewer Americans liv[ing] in the town in which they grew up." Knack, *Why We Don't Vote—Or Say "Thank You,"* Wall St. J., Dec. 31, 1990, at 6, col. 3.

220. The franchisee in *Hoffman*, for example, did not deal with "Red Owl Stores" in his negotiations. He dealt with a business agent for Red Owl in the Wisconsin region. Hoffman v. Red Owl Stores, 26 Wis. 2d 683, 686-90, 133 N.W.2d 267, 268-71 (1965). In recruiting franchisees in another region, it is unlikely that Red Owl would suffer direct reputational effects from the Hoffman episode. Even if it did, it could claim plausibly—perhaps even truthfully—that the Wisconsin business agent acted outside company policy. *See* Gergen, *supra* note 10, at 33 n.157 (quoting Hoffman's testimony that Red Owl's agent was transferred to other duties after the episode that gave rise to Hoffman's claim).

221. Many forms of opportunism are subtle and can be disclaimed by the opportunist, leaving those outsiders who do hear about the opportunist's reputation to question the real truth. Gambetta, *supra* note 152, at 233-34 (asserting that reputation cannot solve the problem of trust because information is difficult to gather, past behavior may not predict future behavior, proof of trustworthiness may be limited to evidence that the party has not acted opportunistically, and any existing evidence may be misinterpreted based on predispositional biases); Good, *Individuals, Interpersonal Relations and Trust*, in COOPERATIVE RELATIONS, *supra* note 8, at 38 (stating that reputation information "will often be ambiguous and open to many readings").

222. Lorenz, *supra* note 8, at 207 (stating that reputation information is "frequently impossible" to transmit and business firms tend to rely more on their own experience).

fective means of transmitting reputational information to the national market.[223] Ironically, however, without a basis for legal actions against opportunists, this information would be unavailable because there would be no judicial opinions, court orders, or media reports of lawsuits.[224]

It is doubtful, therefore, that nonlegal sanctions alone adequately deter opportunism in the precontractual phase of business dealings. The existence of precontractual opportunism lawsuits is some evidence that reputational incentives do not always induce trust and reliability in the initial bargaining interactions. As a matter of theory, there is reason to expect opportunistic conduct by habitual opportunists, parties in one-time transactions, parties near the end of a series of discrete contracts, and participants in markets characterized by high mobility.

2. The Costs of Making Legal Sanctions Available

Even assuming that nonmarket deterrents are weak in certain commercial circumstances, one still must question whether legal regulation is an appropriate response to bargaining opportunism. Using the legal system to deter opportunism is costly. If these costs outweigh the benefits of legal regulation, then society is better off leaving opportunistic behavior to market forces.

a. Opportunistic Lawsuits

First, legal rules paradoxically can encourage precisely the behavior they are designed to deter. For example, Part II of this Article discussed how a rule granting the right to sue for trade secret misappropriation to legitimate sellers of proprietary information may encourage opportunists to flood potential buyers with vagne concepts and later file spurious legal claims.[225] Moreover, making subcontractors' bids irrevocable for a reasonable time after the prime contractor is awarded a contract may enable prime contractors to shop or renegotiate these bids opportunistically.[226]

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223. Computer searches to discover pending and past legal actions regarding opposing parties in business negotiations are a common practice in preparing for business deals between sophisticated parties. This practice includes searches of legal and newspaper texts, judicial opinions and orders, and reports of lawsuits being filed in news journals. Relles, *On-Line Services Help Marketing*, Legal Times, Feb. 19, 1990, § 10, col. 1.

224. In addition, some markets may have only a limited number of buyers or sellers. While this increases the reputation effect as a general matter, "firms cannot easily avoid opportunistic organizations because of the small numbers problem." Provan & Skinner, *supra* note 208, at 202. In these markets bad reputations simply put people on their guard and raise the costs of transacting business for everyone.

225. *See supra* note 74 and accompanying text.

226. *See supra* note 122.

Legal intervention thus can result in opportunistic behavior. The question therefore is which is greater: The amount of opportunistic behavior that arises in the absence of legal sanctions or the amount of opportunism caused by the imposition of legal sanctions. At present, there is no empirical answer to this question, and reasonable people could reach different conclusions. My intuition is that unregulated opportunism is the more costly of the two.

First, contract-specific investments are costly, and pursuing a legal claim is both expensive and uncertain. A successful claim requires proof that parties actually took costly risks. This prerequisite makes it difficult for parties casually to invoke the legal system without some basis for their claim. Some parties may be able to fabricate precontractual investments on occasion, but systematic, widespread opportunism based on exploited legal protections seems unlikely.

Second, the legal system is flexible and can respond to new forms of opportunism that arise as a result of legal regulation. For example, when inventors proved to be opportunistic, the legal system adjusted by recognizing and enforcing buyers' "anticonfidentiality" agreements.[227] These waivers are inexpensive to draft, and the courts, as well as the market for games and inventions, regulate their use.[228]

In the subcontractor-contractor context, the law has developed rules to penalize and deter possible contractor opportunism stemming from the *Star Paving* line of cases. If a contractor tries to renegotiate the price of a subcontractor's bid after the main contract has been awarded, the contractor loses the right to enforce the subcontractor's bid and may be forced to accept a higher price.[229] This may not be a perfect solution when the prime contractor has significant market-power advantages, but it does restore the legal balance found in *Gimbel* and undercuts the possible harm of a *Star Paving* rule.

b. *Overprotection of Naive Negotiators*

Legal regulation designed to deter bargaining opportunism could produce another undesirable side effect: encouraging parties who are overly cooperative or naive to choose careers in business.[230] Prudent

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227. The law construes these agreements strictly, however, in order to be fair to inventors. *See supra* note 78 and accompanying text.

228. If anticonfidentiality agreements unduly chill the production of new and useful ideas, firms seeking a competitive advantage will search for new methods of review that do not require waivers.

229. *See supra* note 122.

230. *See* R. DAWES, RATIONAL CHOICE IN AN UNCERTAIN WORLD 197 (1988) (reporting that about 25% of subjects in an experiment cooperated no matter what their opponents did); M. DEUTSCH, *supra* note 14, at 169-76 (discussing people who are disposed to "pathological trust" and for a variety of reasons, ranging from extreme overconfidence to extreme naivety, compulsively fail

levels of suspicion are healthy and helpful in many mixed-motive business dealings.[231] Naive negotiators expecting trustful cooperation will be victimized, thereby incurring psychological and economic costs themselves, imposing these costs on their dependents, and clogging the courts with complaints. In the absence of legal rules providing recompense, naive negotiators quickly will be driven from the market. Protective legal rules may retard this process.

This fear of encouraging naive market participants prompts several responses. First, as argued above, legal rules are costly to enforce and do not compensate victims perfectly.[232] The truly naive will not return eagerly to the business world even though they have proven legally that their reliance or trust was reasonable under the circumstances.[233] Providing compensation, however, may protect them from financial ruin and provide some deterrence against exploitation of reasonable trusting behavior.[234] Moreover, some naive negotiators will mature and acquire the skills needed to navigate mixed-motive waters. Compensation for damage resulting from inexperience, then, will enable these parties to continue their business careers.

Second, a lack of legal regulation might drive out high-trust persons[235] as well as those who trust compulsively. High-trust personalities are more willing than low-trust personalities to give strangers the benefit of the doubt absent any definitive information about the stranger's pattern of behavior.[236] High-trust personalities often are extremely trustworthy people. Moreover, research has shown that high-trust personalities, as opposed to the truly naive, are not more gullible than those with low-trust personalities.[237] Hence, high-trust people are quite

to assess the risks of opportunism in mixed-motive situations). Research also suggests that some percentage of people are "committed cooperators" based on principle. Hofstadter, *Metamagical Themes*, 248 SCI. AM., June 1983, at 14, 27 (finding that 6 out of 20 sophisticated theorists chose to cooperate with authorities in a single transaction prisoners' dilemma based on the sentiment that they would rather pay and be right). Both pathological and committed cooperators may be too rigid in their approach to trust to excel in the business world in which mixed-motive situations are common and can be quite costly to victims of exploitation.

231. *See supra* notes 143-45 and accompanying text.

232. *See supra* note 200 and accompanying text.

233. The danger of overprotection is lessened somewhat because the doctrinal requirements of promissory estoppel and promissory fraud claims screen out unreasonable business behavior by plaintiffs. *See supra* notes 80-88, 102-14 and accompanying text.

234. Mr. Hoffman gave up on franchising after his experience with Red Owl Stores and became an insurance salesperson for a large company. *See supra* note 87. This transition, however, was made smoother by the settlement he won from Red Owl. *Id.*

235. *See supra* note 164.

236. R. LEWICKI & L. LITTERER, *supra* note 51, at 272; J. RUBIN & B. BROWN, *supra* note 51, at 183 (discussing findings that trusting people are more likely to be trustworthy and, hence, more likely to be stable partners in cooperative relations).

237. Rotter, *Interpersonal Trust, Trustworthiness and Gullibility*, 35 AM. PSYCHOLOGIST 1, 6

capable of sustaining productive business relationships.[238] A legal regime that drives high-trust personalities out of the market, therefore, would not increase the level of market savvy practiced in business or eliminate court congestion. Instead, the regime would eliminate a group of people most likely to promote efficiency-enhancing cooperation.

c. Legal Uncertainty

Because legal rules deterring opportunism are imprecise, they will add costs to conventional bargaining transactions. Additional transaction costs occasionally may cause potential defendants to forego certain transactions or at least reduce the volume of their negotiations. A lack of legal regulation, however, is likely to make high-risk cooperative moves even riskier and less frequent, thus driving potential plaintiffs away from the bargaining table. It is unclear which danger imposes the greater potential costs. Given the difficulty of solving the mixed-motive puzzle and the specific type of opportunistic conduct addressed in this Article, however, carefully circumscribed legal regulation seems justified.

d. Dilution of Trustworthiness Signals

Precontractual investments serve two functions in the construction of trusting relationships. They can signal both that a party is trustworthy and that a party is willing to trust the other side. Imposing legal sanctions on opportunistic behavior undermines the effectiveness of these signals: the sanctions dilute the trustworthiness conveyed through high-risk moves. Because the party receiving the signal knows that exploiting the risky behavior is subject to legal recourse, the precontractual investments are less risky and reveal less about the risk-taking party.

If the legal system were perfect and all violations of trust could be compensated fully, there would be no such thing as a high-risk step in bargaining. People would act based on the threat of legal sanction, not trust.[239] In reality, however, precontractual investments remain risky even when the law punishes opportunistic behavior because the costs of bringing a suit based on opportunistic conduct are high, evidentiary proof is uncertain, and actual recoveries often are limited in amount. Thus, although the trust signal is weakened by legal regulation, the signal retains sufficient force to convey meaning in the trust-building

(1980).

238. *Id.*

239. N. LUHMANN, *supra* note 15, at 35 (stating that "trust cannot be reduced to trust in the law and in the sanctions which the law makes possible").

process.

Moreover, as long as legal sanctions for breach of trust are not the subject of explicit bargaining, these sanctions can serve a reassurance function without poisoning the emerging atmosphere of trust. If, as legal economists suggest, parties must secure express contractual protections regarding trustworthiness, the very process of securing these protections is likely to put these parties on their guard.[240]

B. *Toward a New Cause of Action: Opportunistic Breach of the Bargaining Relationship*

Assuming the law should deter opportunism during the precontractual period, one must ask whether the array of doctrines explored in Part II adequately accomplish this purpose. These doctrines often require substantial manipulation to achieve the desired results, thereby adding unnecessary cost and confusion to the deterrence of bargaining opportunism.

One alternative to present doctrines would be the imposition of a general duty of good faith on all parties in commercial negotiation. Some commentators have argued that the courts should adopt this standard.[241] Others have suggested that some of the cases discussed in Part II demonstrate an evolution by American courts toward a European, civil-law model of good faith in bargaining.[242]

The analysis presented in this Article suggests that, from a purely descriptive perspective, American courts are not as concerned with general notions of good faith as they are with compensating victims of opportunistic conduct who have invested transaction-specific assets during negotiation. Moreover, from a normative perspective, a legal regime based expressly on a good faith standard appears ill-suited to provide the best legal protection against opportunistic conduct.

First, a regime based on good faith likely would be overbroad. A vague good faith standard allows courts to punish not only opportunism, but also any other conduct they consider unsavory or unethical.[243]

240. *Id.* at 36 (stating that the structure of a trusting relationship requires that the calculation regarding legal sanctions remain "latent . . . purely as a reassuring consideration").

241. *See, e.g.*, Hassan, *The Principle of Good Faith in the Formation of Contracts*, 5 SUFFOLK TRANSNAT'L L.J. 1 (1980); Kessler & Fine, *supra* note 11, at 448-49; Note, *A Call for a Common Law* Culpa in Contrahendo *Counterpart*, 15 U.S.F. L. REV. 587 (1981).

242. *See, e.g.*, Summers, *"Good Faith" in General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195 (1968); Note, *Restructuring Breach of the Implied Covenant of Good Faith and Fair Dealing As a Tort*, 73 CALIF. L. REV. 1291, 1316-18 (1985). Other scholars looking at the same cases have rejected this view. *See* Farnsworth, *supra* note 10, at 285.

243. R. POSNER, *supra* note 2, at 44 (asserting that a general legal standard, "by vesting broad discretion in the officials applying it, . . . opens the way to abuse"); Shell, *Substituting*

Courts therefore might impose sanctions for bargaining ploys such as withdrawing prior concessions or exaggerating statements of commitment that some industries countenance without difficulty.

Second, a good faith regime would impose high costs on the bargaining interaction because of uncertainty.[244] Even after considerable elaboration by the courts, a general doctrine of good faith likely would be open-ended. Parties therefore would be forced to predict what conduct might offend particular judges or juries. Faced with this uncertainty, some parties might forego bargaining altogether, and many would spend resources attempting to contract around the good faith standard.

A better alternative than either current doctrine or a good faith standard would be to construct a new liability rule designed specifically to deter the opportunistic bargaining conduct identified and discussed in this Article. I propose that such a new cause of action be called "Opportunistic Breach of the Bargaining Relationship." Properly framed, it would give parties and courts improved guidance in planning behavior and deciding cases.

The doctrine of Opportunistic Breach of the Bargaining Relationship that I have formulated poses four factual questions to determine liability. First, it asks whether the disputed conduct stemmed from a precontractual bargaining interaction. Gifts, discussions that do not contemplate a commercial exchange, and attempts to renegotiate after a contract is formed would not be covered by the proposed cause of action.[245]

The second element asks whether the defendant sigualed that the parties dispense with formal contract law protections and conduct themselves based on mutual trust. The defendant could make this signal by words, conduct, or even silence when commercial practice would suggest a duty to speak. The explicit promise of a future contract or of reimbursement for precontractual investments certainly would qualify

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Ethical Standards for Common Law Rules in Commercial Cases: An Emerging Statutory Trend, 82 Nw. U.L. Rev. 1198, 1243 (1988).

244. R. Posner, *supra* note 2, at 45 (asserting that the regime of general legal standards makes it harder to predict the outcome of legal cases and adds "cost and disutility" to the legal system); Shell, *supra* note 243, at 1242.

245. Parties who negotiate a series of discrete contracts over an extended period of time would satisfy this element. Professor Narasimhan has demonstrated that negotiations of this sort sometimes resemble renegotiations of existing contracts. *See* Narasimhan, *Relationship or Boundary*, *supra* note 4, at 1077, 1085-86. Because an entirely new contract is at issue, however, and the parties may be troubled by "last-period" incentives to behave opportunistically, *see supra* note 216, these cases should properly fall under the proposed rule. Markov v. ABC Transfer & Storage Co., 76 Wash. 2d 388, 457 P.2d 535 (1969), is an example of a judicial response to such a case. *See supra* note 114; *see also* Greeustein v. Flatley, 19 Mass. App. Ct. 351, 474 N.E.2d 1130 (1985) (concerning a commercial lease renewal).

as such a signal. Many other forms of communication also could satisfy this element. For example, assurances of trustworthiness and dependability, or suggestions that final approval of a contract is a mere formality, could be sufficient. Even apparently casual assurances between parties with long-standing social ties might suffice.[246] Reflecting the *Dravo* holding, a complete absence of overt assurances may qualify when accompanied by a request to reveal proprietary information or perform costly services in furtherance of the parties' mutual interests.[247]

The third element of the claim requires evidence that the plaintiff took costly steps designed to further the parties' mutual interests. Requiring proof of high-risk steps limits claimants to those who have invested substantial assets in the trust-building process and minimizes the danger that opportunists will bring spurious claims based on low-risk investments.[248] The costs of negotiation itself, including legal fees and investigation expenses, are anticipated by both sides in commercial

246. The proposed doctrine of Opportunistic Breach of the Bargaining Relationship, consistent with the psychological research reviewed in Part III, recognizes that social relations between business parties contribute to the trust-building process. *See supra* notes 172-76 and accompanying text. Courts therefore should give weight to this facet of the bargaining relationship. *See, e.g., In re* Phillips, 804 F.2d 930 (6th Cir. 1986) (holding that a creditor with a 25-year social friendship with debtor, based on shared church activities, was reasonable in relying on debtor's false representation of acreage on deed); RCM Supply Co. v. Hunter Douglas, Inc., 686 F.2d 1074, 1079 (4th Cir. 1982) (Sprouse, J., concurring and dissenting) (pointing to evidence of a close friendship between negotiating parties as a factor supporting a finding of reasonable reliance); *In re* Paolino, 89 Bankr. 453 (Bankr. E.D. Pa. 1988) (holding that a creditor was reasonable in relying on legal documents provided by debtor when the parties had a long social relationship and debtor's husband was creditor's family doctor); Broomfield v. Kosow, 349 Mass. 749, 212 N.E.2d 556 (1965) (finding a constructive trust based on a close business and personal relationship). *But see* Maguire v. Holcomb, 169 Ill. App. 3d 238, 523 N.E.2d 688 (1988) (finding no fiduciary duty between business parties even though the parties had a long-standing social relationship and the defendant had been a student-advisor to plaintiff five years previously); Eaton v. Sontag, 387 A.2d 33 (Me. 1978) (finding that a social friendship of 15 years between buyers and sellers does not create a confidential relationship).

247. In this respect, the proposed cause of action would cover more cases than would Professor Gergen's suggestion that courts use negligent misrepresentation to address cases arising from precontractual reliance. *See* Gergen, *supra* note 10, at 43 (noting that claim for negligent misrepresentation requires a "statement of fact"). The proposed doctrine also disagrees with the suggestion of the Second Circuit in Walton v. Morgan, Stanley & Co., 623 F.2d 796 (2d Cir. 1980), that disclosure of proprietary information during bargaining does nothing to change the arm's length nature of an exchange. *See supra* note 68. The precise holding in *Walton* dealt with liability for insider trading under the federal securities laws, a subject far beyond the scope of this Article. Finally, the proposed cause of action is in sharp contrast with Professor David Charny's suggested reform of promissory estoppel doctrine to require proof that a promise was made and that the promisee "misapprehends the probability that the promisor will breach the promise or, though correctly apprehending that probability, could not efficiently incur the costs of obtaining an enforceable contract provision that anticipates the breach." Charny, *supra* note 47, at 456.

248. This requirement contrasts with the nominal reliance required under the *Restatement (Second) of Contracts* for claims of promissory estoppel. *Compare* RESTATEMENT (SECOND) OF CONTRACTS § 90(1) (1981) (requiring only "action or forbearance") *with* RESTATEMENT OF CONTRACTS § 90 (1932) (requiring "action or forbearance of a definite and substantial character").

transactions. Thus, they should not be considered transaction-specific investments for purposes of determining whether this element is satisfied. The exclusion of normal negotiation costs from the category of compensable precontractual investments is consistent with current cases that have denied relief based solely on the loss of normal bargaining expenses.[249]

The fourth and final element requires the plaintiff to prove that the defendant's action or omission caused the plaintiff's alleged loss. A causation requirement is vital to filter out cases in which the plaintiff acted out of personal necessity or desperation, rather than in response to the defendant's behavior. If the court finds that the plaintiff would have made the transaction-specific investments regardless of any acts or omissions by the defendant, then the plaintiff's claim should fail.[250] Affirmative proof on all four of the foregoing elements would entitle the plaintiff to reliance damages.

The virtue of an explicit cause of action remedying precontractual opportunistic behavior is that it defines the precise boundaries of a form of recurring commercial misconduct that, until now, has been hidden beneath the surface of a wide variety of legal cases. The new claim permits courts to evaluate the facts presented without having to fit the parties' conduct into ill-suited doctrinal categories. For example, some courts addressing promissory estoppel claims require strict proof that a

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249. *See, e.g.*, Gruen Indus. v. Biller, 608 F.2d 274, 282 (7th Cir. 1979) (reasoning that "[e]very businessman faces the risk that the substantial transaction costs necessary to bring about a mutually beneficial contract will be lost if the negotiations fail to yield a satisfactory agreement"); *In re* MBA, Inc., 51 Bankr. 966, 972 (Bankr. E.D. Va. 1985); Songbird Jet Ltd. v. Amax, 581 F. Supp. 912, 926 (S.D.N.Y. 1984) (finding that no claim was stated for negotiation expenses based on theory of unjust enrichment); *see also* Farnsworth, *supra* note 10, at 231. Damages for negotiation expenses theoretically might be available under a claim of fraud if the plaintiff could show that the negotiations were a complete sham designed solely to occupy the plaintiff while the defendant undertook other activities. Research, however, has disclosed no such case. *But cf.* Gray v. Eskimo Pie Corp., 244 F. Supp. 785 (D. Del. 1965) (plaintiff claimed that defendant kept plaintiff occupied in negotiations while defendant prepared to launch a competing product line, but the complaint was dismissed because the court found as a fact that plaintiff did not rely on defendant's representations regarding the prospects for a contract). In the highly specialized context of government contracts, claims for negotiation expenses have been recognized when the federal government requests bids and then arbitrarily fails to choose the lowest bid. Disappointed bidders in these situations may be entitled to recover their costs of bid preparation. *See* Heyer Prods. Co. v. United States, 140 F. Supp. 409 (Ct. Cl. 1956); Farnsworth, *supra* note 10, at 238-39.

250. The court may find, for example, that the plaintiff's economic circumstances render risky precontractual investments its only hope for survival. In that case the imposition of liability for the plaintiff's losses would not support the trust-building process in commercial exchange. *See, e.g.*, Wright v. United States Rubber Co., 280 F. Supp. 616, 620 (D. Or. 1967) (holding that the plaintiff could not recover under promissory estoppel because he made precontractual investments "not in reliance on promises made by defendant, but in complete desperation on finding no other alternative").

promise was made.[251] In some bargaining opportunism cases, this doctrinal requirement might cause a court to reject a legitimate claim or, at the very least, spend resources canvassing other theories to see if another doctrine could be stretched to fit the facts. The proposed cause of action, by contrast, recognizes that transaction-specific investments reasonably can be induced by conduct that falls short of an explicit promise. The proposed rule thus better describes the actual results of bargaining opportunism cases. This adjustment should lead to more certainty for parties when they are planning their conduct. Similarly, the new cause of action eliminates the need to manipulate labels such as arm's length bargaining and confidential relationships in cases based on disclosure of proprietary information. As this Article has demonstrated, the important question in these cases is whether the parties have opted to construct a bargaining relationship based on trust, not whether they initially approached each other as strangers. The proposed cause of action lessens the likelihood that commercial parties will act based on a false assumption that their arm's length bargaining position will shield them from liability for opportunistic acts.

The use of a consistent, reliance-based measure of damages also improves current doctrine. Courts facing bargaining opportunism claims under unjust enrichment, for example, may undercompensate plaintiffs. *Earhart v. William Low Co.*[252] notwithstanding, unjust enrichment damages typically are limited to benefits actually received, and the defendant may not have benefited directly from the plaintiff's precontractual investments.

Current doctrines also overcompensate plaintiffs in some circumstances. Courts occasionally have awarded expectation damages based on preliminary bargaining conduct.[253] These awards, however, en-

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251. *See, e.g.*, Keil v. Glacier Park, Inc., 188 Mont. 455, 464, 614 P.2d 502, 507 (1980) (holding that the promise must be "clear and unambiguous"); Feinman, *supra* note 10, at 691 (stating that some courts hold the view "that a statement that is not specifically demonstrative of an intention respecting future conduct or that is indefinite or limited cannot be the basis for promissory estoppel").

252. 25 Cal. 3d 503, 600 P.2d 1344, 158 Cal. Rptr. 887 (1979); *see supra* notes 89-91 and accompanying text.

253. A few courts have held that elaborate, time-consuming negotiations ultimately create a duty to negotiate "in good faith," the breach of which results in a claim for lost expectation damages even in the absence of contract-specific investments. *See, e.g.*, Teachers Ins. & Annuity Ass'n of Am. v. Tribune Co., 670 F. Supp. 491 (S.D.N.Y. 1987) (deciding case in which interest rates plunged during loan negotiations causing borrower to refuse to close); Teachers Ins. & Annuity Ass'n of Am. v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986) (same); Evans, Inc. v. Tiffany & Co., 416 F. Supp. 224 (N.D. Ill. 1976) (deciding case in which personality clashes developed between landlord and prospective tenant causing tenant to back out of deal). Most courts, however, have held that complex negotiations do not create duties to negotiate in good faith or give rise to claims for lost expectations, especially when the terms of a preliminary agreement or letter of intent reserve the right of a party to back out. *See, e.g.*, Feldman v. Allegheny Int'l, Inc., 850 F.2d 1217 (7th Cir.

courage parties to invest assets prematurely to trap their opponents into what may be an unwanted deal. The remedy limitation in the new opportunistic breach claim discourages behavior designed to lock parties into unwanted contracts.[254] Prohibiting recovery of normal negotiating expenses, moreover, discourages frivolous suits by parties that simply are disappointed in the results of a conventional arm's length negotiation.

These same policy considerations counsel against awarding punitive damages for bargaining opportunism. Punitive damages clearly would deter opportunistic conduct, but this deterrence would come at a great cost to the commercial bargaining arena. First, parties might avoid the arena altogether if faced with the prospect of punitive damages for precontractual behavior. Second, punitive awards would encourage plaintiffs with questionable claims to bring suit and gamble on a favorable settlement, even if they reasonably cannot hope to prevail at trial. Both effects would inhibit the communication and exchange process considerably.

Certain parties, of course, may not want an informal negotiation regime based on mutual trust. For reasons of clarity, certainty, or economy, these parties may prefer to bargain at arm's length with no intention to make transaction-specific investments themselves and no desire to risk liability for investments incurred by the other side. Under the proposed rule, parties must indicate this preference clearly and consistently to avoid potential liability. Under current practice, parties easily can communicate their preference through prominent disclaimers in letters of intent and press releases. Parties wishing to proceed without any risk of liability still should take care to avoid giving any impression to their opponent that they want to proceed under a trust-based bargaining regime.

Although parties should be free to "opt out" of the new claim, courts should examine carefully the overall message sent by a party before determining that explicit disclaimer language releases a defendant from liability for its opponent's precontractual investments. The

1988); Reprosystem, B.V. v. SCM Corp., 727 F.2d 257 (2d Cir. 1984) (reversing district court holding that the defendant had a duty to negotiate in good faith and awarding lost expectation damages based on letter of intent), *cert. denied*, 469 U.S. 828 (1984); Bernstein v. Felske, 143 A.D.2d 863, 533 N.Y.S.2d 538 (1988) (finding no duty to negotiate in good faith when the preliminary agreement was conditioned expressly on signing formal contract documents).

254. It is possible that the reliance measure of damages in a particular case will be measurable only by the lost expectation of the victim of opportunism. In the construction bidding cases, for example, the prime contractor's reliance on the subcontractor's bid results in damages that equal expectation losses. *See* Slawson, *The Role of Reliance in Contract Damages*, 76 CORNELL L. REV. 197, 220-22 (1990) (discussing the difficulty of measuring actual reliance damages in construction bidding cases).

presence of these investments suggests that, unless the investor was irrational or desperate, it acted in response to a signal sent by the other side or on the basis of some industry-wide convention. Depending on the circumstances, boilerplate language in letters of intent and press releases may be understood by the parties to be a formal bargaining ritual played out for the benefit of third parties or constituencies, not a substantive part of the business relationship. When these formalities are contradicted by repeated assurances that mutual trust is the basis for the negotiations, however, precontractual investments made in reliance on trust should be protected from opportunism.

V. Conclusion

This Article has sought to fill gaps in both doctrinal and law and economics literature dealing with contract formation. Doctrinal studies have focused on the problems of negotiation misconduct, but have failed to uncover any unifying theme that rationalizes the many judicial responses to negotiation abuses. Law and economics scholars, meanwhile, have focused significant attention on the theme of opportunistic conduct, but have failed to apply this concept to the precontractual period. The Article has argued that the deterrence of opportunism is the unifying theme missing from doctrinal studies of contract formation and that, contrary to the assumptions of law and economics commentators, opportunism is a harmful feature of the precontractual stage of business dealings. Complex commercial negotiations take place over a period of time and often require parties to take sequenced steps that expose them to losses before contract formation. The courts have used a wide variety of legal doctrines to compensate parties who expose themselves to losses during negotiations and, consequently, are exploited by their bargaining partners.

The law is not the only mechanism for deterring opportunistic behavior in negotiations. Some parties defend against opportunism through their ability to discern and avoid potential opportunists. Others may dodge opportunism by merging with other firms to internalize potentially opportunistic transactions. Primarily, parties rely on the prospects for future dealings with each other and the market value of reputation as incentives to bolster cooperation. This Article, however, has pointed out the shortcomings of these mechanisms in particular circumstances. Moreover, the Article has constructed a new cause of action called "Opportunistic Breach of the Bargaining Relationship," which provides commercial parties with a clearer understanding of what behavior troubles the courts.

The Article has argued that legal regulation of negotiation, either under the existing rules or a new cause of action, is socially beneficial.

Legal sanctions support a vital process of trust building that uses high-risk steps as signals and encourages parties that prefer negotiation based on trust to enter and remain in the bargaining arena. Research findings by social psychologists and others who have studied the dynamics of interpersonal trust strongly support the conclusion that precontractual transaction-specific investments serve an important function in the construction of durable commercial relationships. Indeed, the role of trust in human interactions has implications not only for the law governing commercial negotiations, but also for fields as widely separated as relational contract theory,[255] economic analysis,[256] and even feminist jurisprudence.[257]

As our society moves toward ever more mobile and competitive markets, the traditional, nonlegal mechanisms for assuring trust are likely to erode.[258] As a result, the state increasingly will serve as a guarantor of the norms of human behavior.[259] This Article has shown that the courts recognize the importance of trust in a vital form of commercial interaction negotiation. The legal system's ability to recognize the role of trust in other arenas of human activity will assume even greater importance as we move into the next century.

255. The phenomenon of trust is important to relational contract theory. I. MACNEIL, THE NEW SOCIAL CONTRACT 68, 74-75 (1980). Relational scholars, however, have not yet explored the concept of trust in detail in any particular field of law.

256. Economists have recognized the importance of trust in commercial dealings. *See supra* note 16 and accompanying text. Because trust is difficult to quantify, however, Dasgupta, *supra* note 170, at 51 (asserting that "there are no obvious units in which trust can be measured"), economists have not accounted for trust adequately in most models of self-interested behavior. *See* A. ETZIONI, THE MORAL DIMENSION 7-8 (1988) (discussing the inadequate treatment of trust by both liberal and conservative economists).

257. Men and women appear to bring different amounts and perhaps kinds of trust to various interactions. *See* H. RAIFFA, *supra* note 126, at 123 (asserting that women tend to be more trusting and trustworthy than men in initial bargaining interactions but less likely to forgive violations of trust). Legal rules that reinforce and reward male trust tendencies might force women to acquire unnatural and even inefficient modes of behavior.

258. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704, 720 (1931) (observing that nonlegal forces holding society together fail with increases in mobility of institutions, residence, and occupation).

259. *See* Hillman, *The Crisis in Modern Contract Theory*, 67 TEX. L. REV. 103, 135 (1988) (arguing that contract law serves as a "safety valve" for occasions when "informality fail[s]" and that the law reinforces "relational norms"); Stookey, *Trials and Tribulations: Crises, Litigation, and Legal Change*, 24 LAW & SOC'Y REV. 497, 498 (1990) (remarking that under the "consensus theory" of relationship between society and litigation, "litigation functions to achieve social integration when traditional forms of nonstate control weaken").