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# SYMPOSIA

## FUNCTIONAL CONTRACTING: RE-CONCEPTUALIZING BUSINESS CONTRACTS IN THE FACE OF NEW FORMS OF PRODUCTION

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TABLE OF CONTENTS



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## ABSTRACT

Alongside bilateral one-off transactions, contracts are used to govern the dynamic, multi-tiered production networks that constitute a majority of global commerce today. Contract law and contract theory do not reflect this change in contractual modalities. In this paper, we look first to summarize earlier theories of contract and posit that the theory of *functional contracting* offers a novel and more useful approach for understanding contractually governed dynamic and multitiered transactions. We then underscore the difference between functional contracting and earlier theories by describing a recent practical case on the contractual governance of business-model transitions. Finally, on the basis of the theoretical comparison, case study, and other related case studies, we evaluate how the model of functional contracting helps legal scholars and practitioners to understand changes in contractual modalities brought about by recent changes in the global economy.

## I. INTRODUCTION

Existing contract theories often seem incapable of addressing the new reality of economic production. Instead of the classical one-off transactions between independent entities that contract theories have primarily focused on, production increasingly occurs through multiple recurrent interactions in fragmented production networks. The networks, in turn, often consist of multiple tiers of, on the face, independent but, in practice, highly integrated entities.

In this article, we formulate a theoretical approach to understanding the business contracts that govern the newly emergent complex forms of economic production. We also highlight the changes the contracts entail to our fundamental understanding of contract law and contractual practice.

The theory of "functional contracting" serves as the starting point of this effort. The functional contracting theory mashes up aspects from several existing contract theories while simultaneously recasting many of their fundamental tenets.

First, contracts can be understood to function as distinctly legal instruments in allocating rights between parties and safeguarding party interests, as the gist of neoclassical contract theory suggests. However, contracts can also coordinate complex interactions in the grey zone of multilateral and multitiered governance, where transaction cost economics suggest they could not function, and neoclassical contracting often breaks down. Third, contracts can also be used in a genuinely relational register to manage dynamic bilateral relationships alongside the tools of relational governance.

In the following, we will argue that the theory of functional contracting recognizes the inherent multivalence of contemporary business contracts and the manifold functions they serve in the governance of business relationships. This recognition of multivalence provides a starting point for reconceptualizing business contracts and how they function. We argue that current theories of contract, from neoclassical to relational and transaction cost economics, are informed by an imaginary obsession with legal bindingness and enforcement. We think this imagination is misguided. Contracts should, instead, be understood as consisting of multiple contractual point intervention techniques with multiple efficacy mechanisms animating them.

The reconceptualization, in turn, provides several insights into how scholarly theories of contract and the contemporary practice of complex business contracting can be reconciled. These insights range from new perspectives on contractual form and contractual effectivities to the new roles of legal scholars and practitioners. Two are particularly crucial. First, focusing on the functions of contractual tools in governing business relationships

allows us to recognize the multiple valences in which contracts are used. As a consequence, hitherto anomalous contractual terms and techniques gain an explanation. Second, as the analysis of contractual impact mechanisms discloses a variegated roster of actors that contracts target and enroll, we gain an ability to explain why contemporary entity and contract boundary-spanning contractual governance is possible.

The paper proceeds as follows. Section II discusses the new norm of contractually organized production networks and earlier contract theories that fail to conceptualize how legal contracts can be used to govern them. In Section III, we describe the theory of *functional contracting* and posit that it provides a better foundation for understanding contracting under new forms of production. In Section IV, we focus on a case study of the contractual governance of a complex, research and development (R&D)-infused sales transaction to highlight how functional contracting allows us, in practice, to conceptualize new contractual modalities. In Section V, we round up the changes entailed by new forms of production and the theoretical insight of functional contracting for contract theory, law, and practice. A brief conclusion sums up the paper.

## II. CONTRACTS IN SEARCH OF THEORY IN THE TRANSFORMATION OF PRODUCTION

Production structures have undergone a fundamental shift during the last fifty years. The Fordist, vertically integrated factories operating under the direct ownership control of one central authority have closed. Firms have shipped production to dispersed locations around the world. The ensuing *global value chains* or *production networks* often span multiple continents, with intermediate and final goods traveling from one end of the world to another during production and distribution.[1]

The chains and networks can consist of dozens, if not hundreds or thousands or millions of independent firms and other actors and, if extended to the governance of users of products, exponentially more so.[2] Transport,

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[1] WILLIAM MILBERG & DEBORAH WINKLER, OUTSOURCING ECONOMICS: GLOBAL VALUE CHAINS IN CAPITALIST DEVELOPMENT (2013); RICHARD BALDWIN, THE GLOBOTICS UPHEAVAL: GLOBALIZATION, ROBOTICS, AND THE FUTURE OF WORK (2019); World Bank & WTO, *Global Value Chain Report 2019: Technological Innovation, Supply Chain Trade, and Workers in a Globalized World* (2019), http://documents.worldbank.org/curated/en/384161555079173489/Global-Value-Chain-Development-Report-2019-Technological-Innovation-Supply-Chain-Trade-and-Workers-in-a-Globalized-World; Neil M. Coe & Henry Wai Chung Yeung, *Global Production Networks: Mapping recent conceptual developments*, 19 J. ECON. GEOGRAPHY 775, 775–801 (2019).

[2] For just some examples, the global automotive giant BMW refers to "approximately 13000 first-tier suppliers in more than 70 countries". See BMW Financial Services (GB)

communication, and governance technologies hold the chains and networks together and allow firms to find and focus on their core business, be it leveraging high-tech know-how, project or service delivery prowess, intellectual property rights, or having access to exploitatively cheap labor.[3]

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Limited, *Slavery and Human Trafficking Statement for 2017*, available at https://www.bmw.co.uk/content/dam/bmw/marketGB/bmw_co_uk/footer/legal/legal-notice/bmw_uk_ltd_modern_slavery_act_statement_2017.pdf (last visited Aug. 13, 2024, on file with authors). The world's biggest fashion retailer, Shein, refers to "over 5,000 third-party contract manufacturers" and claims to "empower thousands of small and medium-sized businesses, giving them full insight into what our customers want and need". See Shein, *Our Supply Chain*, available at https://www.sheingroup.com/our-business/our-supply-chain/ (last visited Aug. 13, 2024, on file with author). The online platform Temu claims to connect users with "millions of merchandise partners, manufacturers and brands". See Temu, *About Temu*, available at https://www.temu.com/se-en/about-temu.html (last visited Aug. 13, 2024, on file with author). Amazon specifically differentiates between the governance of their own supply chains and those of their "selling partners", that is, the potentially extensive supply chains of third parties selling goods on the Amazon platform, and engages in both. See Amazon, *Modern Slavery Statement* (2023), available at https://sustainability.aboutamazon.com/modern-slavery-statement.pdf (last visited Aug. 13, 2024, on file with authors). Naturally, companies have not only physical but also digital value chains, and thus, for example, one can differentiate between, on the one hand, 'Apple-the-hardware-manufacturer', who refer to thousands of companies in more than fifty countries and regions, and, on the other hand, 'Apple-the-proprietor-of-the-App-Store', who refer to over 42 million registered Apple software developers. Compare Apple, *2023 UK Statement on Efforts to Combat Modern Slavery in Our Business and Supply Chains* (2023), available at https://s203.q4cdn.com/367071867/files/doc_downloads/ReportsandFilings/04/Apple-Combat-Human-Trafficking-and-Slavery-in-Supply-Chain-2023.pdf (last visited Aug. 13, 2024, on file with authors) and Apple, *2023 App Store Transparency Report* (2023), available at https://www.apple.com/legal/more-resources/docs/2023-App-Store-Transparency-Report.pdf (last visited Aug. 13, 2024, on file with authors). Through digital technologies companies have unprecedented visibility over legions of users, collecting detailed information over their interests through their transactions and other interactions in the digital space. Through the internet of things even traditional manufactures have extended visibility over the use of products and services so that, for example, automotive manufacturers are able to collect detailed information over how users drive their cars. E.g., Kashmir Hill, *Automakers Are Sharing Consumers' Driving Behavior With Insurance Companies*, N. Y. TIMES, March 11, 2024, https://www.nytimes.com/2024/03/11/technology/carmakers-driver-tracking-insurance.html (last visited Aug. 13, 2024). Generally on the intersection of value chains and digital platforms, see Jaakko Salminen, Kevin B. Sobel-Read, Mika Viljanen & Klaas Eller, *Digital platforms as second-order lead firms: Beyond the industrial/digital divide in regulating value chains*, 30 EUR. REV. PRIV. LAW 1059 (2022).

[3] For the role of transport and communication technologies in developing new forms of production generally see BALDWIN, *supra* note 1. There is a plethora of material available on individual technologies, such as Daniel M. Bernhofen, Zouheir El-Sahli & Richard Kneller, *Estimating the Effects of the Container Revolution on World Trade*, 98 J. INT'L ECON. 36 (2016); MARC LEVINSON, THE BOX: HOW THE SHIPPING CONTAINER MADE THE WORLD SMALLER AND THE WORLD ECONOMY BIGGER (2006); THOMAS DIETZ, GLOBAL

New ideologies of governance, ranging from centralization for bureaucratical efficiency under the mass manufacturing model to specialization for economic efficiency or the outright outsourcing of governance under platform economies, have sprouted up from technological advances and helped form the ideological foundations of today's outsourced and fragmented production structures.[4]

Contracts provide the crucial legal framework for the emergence of fragmented, dispersed, and decentralized business networks. On the one hand, current contractual paradigms enable a compartmentalization of liability in the networks. The ability to compartmentalize motivates actors to tinker with developing contract-boundary-spanning governance because they can reap the benefits of no liability but still control production.

From a contract theory perspective, this paradox between compartmentalized liability and contract-boundary-spanning governance is a radical transformation of our understanding of the contract. On the other hand, the firms employ contracts as parts of complex, continuous, dynamic, and multiparty governance structures. Private multi-tiered and multiparty governance structures, such as the Bangladesh Accord,[5] have proliferated,[6] and alliance models, open book accounting structures for cost management, and R&D-partnerships have become the norm in many industry sectors.[7] In these structures, firms often deploy contract clauses and structures that eschew the traditional orientation toward codifying deals. The clauses and structures, instead, tend to the parties' relationship, setting up roles, communication

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ORDER BEYOND LAW: HOW INFORMATION AND COMMUNICATION TECHNOLOGIES FACILITATE RELATIONAL CONTRACTING IN INTERNATIONAL TRADE (2014); Tatiana López, Tim Riedler, Heiner Köhnen & Michael Fütterer, *Digital value chain restructuring and labour process transformations in the fast-fashion sector: Evidence from the value chains of Zara & H&M*, 22 GLOBAL NETWORKS 684 (2021).

[4] BALDWIN, *supra* note 1; Coimbatore Krishnarao Prahalad & Gary Hamel, *The Core Competence of the Corporation*, 68 HARV. BUS. REV. 79 (1990).

[5] The Bangladesh Accord is "an independent, legally binding agreement between brands and trade unions to work towards a safe and healthy garment and textile industry in Bangladesh." The Accord was created as a result of The Rana Plaza factory collapse in 2013, "killing 1,133 people and critically injuring thousands more". The functions of the Accord office transitioned to the labour-brands-industry organization called RMG Sustainably Council from June 2020 onwards. ACCORD ON FIRE AND BUILDING SAFETY IN BANGLADESH, https://bangladeshaccord.org/ (last visited Aug. 13, 2024).

[6] RICHARD M. LOCKE, THE PROMISE AND LIMITS OF PRIVATE POWER: PROMOTING LABOR STANDARDS IN A GLOBAL ECONOMY (2013); Jaakko Salminen, *The Accord on Fire and Building Safety in Bangladesh—A New Paradigm for Limiting Buyers' Liability in Global Supply Chains?*, 66 AM. J. COMP. L. 411–451 (2018).

[7] Peter Kajüter & Harri I. Kulmala, *Open-book Accounting in Networks: Potential Achievements and Reasons for Failures*, 16 MGMT. ACCT. RSCH. 179 (2005); Ronald J. Gilson, Charles F Sabel & Robert E Scott, *Contracting for Innovation: Vertical Disintegration and Interfirm Collaboration*, 109 COLUM. L. REV. 431 (2009).

schedules, escalation processes, and cost accountability and transparency regimes.[8]

These innovative contracting structures put a strain on established doctrines and theories of contract. The will-based "classical" understanding of contracting and contracts was obsolete in the nineteenth century. It, of course, still provides the basic framework for thinking about discrete exchanges between the parties. Still, in its zeal to confine futures unambiguously within the rigid formal structure of parties' intent, it easily breaks down. "Neoclassical contract theory", the current standard legal theory, has adapted to incorporate aspects of the social context into its understanding of the contract, thus allowing for some flexibility. However, the theory remains locked inside the exchange model of contract: contracts articulate and present exchanges of discreet performances. The performances are either set out in the contract itself, or their particularities can be interpreted or adapted into being by the operation of contract law rules. Nevertheless, the approach is oblivious to how complex relationships are governed. It remains enthralled by the ex-post mindset of traditional contracting. The only thing neoclassical contracts can say about the new contract devices is that they impose highly complex, contextual obligations on the parties. The obligations, then, must be understood against the social context of the parties' relationship.[9] True, but fatuous.

Although insightful and relevant, developments such as "relational contract theory" and "transaction cost economics" also fall short of providing a foundation for understanding current contractual practice. Relational contract theory emerged during the 1960s out of the empirical observation that formal contracts contributed little to the actual governance of business relationships.[10] Commercial relationships were managed in the shadow of contracts with little regard paid to the contents of the written contracts or the rigors of doctrine until the relationship broke down. Proponents of the relational contract theory argued that contract law was to be adjusted to accommodate the dynamism of real-world business relationships if it wished

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[8] Donald J. Schepker et al., *The Many Futures of Contracts: Moving Beyond Structure and Safeguarding to Coordination and Adaptation*, 40 J. MGMT. 193 (2014); Thomas Mellewigt et al., *What Drives Contract Design in Strategic Alliances? Taking Stock and How to Proceed*, 82 ZEITSCHRIFT FÜR BETRIEBSWIRTSCHAFT 839, 851 (2012); John Hagedoorn & Geerte Hesen, *Contract Law and the Governance of Inter-Firm Technology Partnerships – An Analysis of Different Modes of Partnering and Their Contractual Implications*, 44 J. MGMT. STUD. 342 (2007).

[9] For one view of classical and neo-classical contract law, see Ian R. Macneil, *Relational Contracts Theory: Challenges and Queries*, 94 NW. L. REV. 877 (2000). For the history of classical and neo-classical contract law, see Gordon Smith & Brayden King, *Contracts as Organizations*, 51 ARIZ. L. REV. 1 (2009).

[10] Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOCIO. REV. 55–67 (1963).

to become relevant again.[11] Although relational contract theory led to modest doctrinal advances[12] and added important tools to the toolbox available for managing long-term contracts, its contributions to the governance of multitiered value chains and production networks remain meager. We have come to acknowledge that contracts are dynamic and often require adaptation, mostly through negotiation. Contract law can help by incentivizing or forcing the parties to negotiate.

Transaction cost economics ('TCE'), in turn, focuses on the choice and design of relationship governance modes. For example, Oliver Williamson argued that governance modes oscillate between market governance (simple supply contracts) and hierarchical integration (the firm).[13] Because its focus is on transactional attributes and costs and their influence on the choice of governance technologies, TCE has largely adopted the classical or neoclassical view of contracts and, therefore, lacks a legally viable theory of contracts.[14] The same is true of more orthodox economic contract theory. Moreover, TCE views contracts primarily through the prism of a very specific type of contract: the executory exchange contract. Also, even though contracts and contract-like instruments occupy much of the grey area between the two governance extremes, TCE scholars have never been able to bridge the divide between descriptive economic theory and legal doctrine.[15] Although TCE may be able to explain how firms should and do govern their relationships when the business falls in the grey area between the markets and the firm, it fails to account for the role that contracts as *legal instruments* play in governing the grey area.[16]

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[11] Macneil, *supra* note 9.

[12] Zhong Xing Tan, *Disrupting Doctrine? Revisiting the Doctrinal Impact of Relational Contract Theory*, 39 LEGAL STUD. 98 (2019).

[13] OLIVER E WILLIAMSON, MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION (1975); Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations,* 22 J. L. & ECON. 233 (1979).

[14] TCE, like other non-legal disciplines, builds on abstractions of contract that are removed from contractual practice. *See* Williamson 1979, *supra* note 13, at footnote 24.

[15] *Compare, e.g.,* Walter W. Powell, *Neither Market Nor Hierarchy: Network Forms of Organization*, 12 RSCH. ORGANIZATIONAL BEHAV. 295 (1990), *with* Richard M. Buxbaum, *Is "Network" a Legal Concept?*, 149 J. INSTITUTIONAL THEORETICAL ECON. 698 (1993).

[16] Even if some outgrowths of TCE, such as global value chain theory, explicitly claim to focus on production chains instead of bilateral relations. Gary Gereffi et al., *The Governance of Global Value Chains*, 12 REV. INT'L POL. ECON. 78 (2005). These approaches, however, have their own limitations. *Id.* at 98; Jaakko Salminen, *Towards a Genealogy and Typology of Governance Through Contract Beyond Privity*, 16 EUR. REV. CONT. L. 25 (2020).

## III. FUNCTIONAL CONTRACTING

### *A. Overcoming Earlier Premises Through Functional Separation*

We argue that *functional contracting theory* provides a useful heuristic for understanding the new forms of governance through contract that are emerging around the globe. The theory incorporates aspects from all three main contract theories discussed above (neo-classical, relational, and TCE) while simultaneously recasting many of their fundamental tenets. At its core is the belief that three function clusters are prevalent in business contracts. Firms use contracts to safeguard their interests, adapt to changing circumstances, and coordinate cooperation. With its emphasis on a multivalent use of contracts, the theory allows us to overcome the limits of earlier theories on contracts and gives us the tools and resources to make sense of and understand contracting in the complex, fragmented value chains and production networks characteristic of the current capitalist economy.[17]

First, the theory highlights the adaptation and coordination functions of contracts in addition to the more traditional safeguarding of rights. This allows us to conceptualize the dominant role of safeguarding as the core function of contracts and place *contracts* in the dead center of business governance. Second, the theory facilitates the multiplication of contract imaginaries. Contracts can be traditional legal instruments. They are and can be used to allocate rights and safeguard party interests, as the gist of neoclassical contract theory and TCE suggests. Contracts, however, can also be used in a relational register to manage dynamic relationships alongside the tools offered by relational governance.[18] Finally, contracts can be used to coordinate parties' complex interactions in the grey zone of multilateral and multitiered network governance across privity boundaries.

The following discusses the three functions in some detail. The main focus is, however, on the coordination function.

### *B. Two Established Contractual Functions: Safeguarding and Adaption*

Law school teaches all lawyers to use contracts to safeguard client interests. In safeguard contracting, the basic patterns resemble the imaginary

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[17] Schepker et al., *supra* note 8.

[18] Relational governance refers to informal governance mechanisms, such as trust, flexibility, solidarity, and other social norms. They arise from the values and agreed-upon processes within a relationship. *See, e.g.*, Jeffrey H. Dyer & Harbir Singh, *The Relational View: Cooperative Strategy and Sources of Interorganizational Competitive Advantage*, 23 ACAD. MGMT. REV. 660 (1998); Laura Poppo & Todd Zenger, *Do Formal Contracts and Relational Governance Function as Substitutes or Complements?*, 23 STRATEGIC MGMT. J. 707 (2002).

underlying classical contract law. The parties use contracts as instruments that lock down the future, articulate distributive outcomes, and prepare for future disputes and enforcement action in case the brute binding force of the contract fails to secure performance.[19]

The vocabulary of contract is rights and duties. The primary function of the contract is to establish rights to receive discrete, clearly defined, and delineated objects, either goods or services or to render them to the counterparty. The contract is self-contained and disconnected from its environment. Whatever happens in the outside world, the contract remains.

Even if the hope is that the contract by itself will be sufficient to bind and prompt performance by the counterparty, the contract attaches to the state's enforcement machinery that upholds and executes rights. Enforcement is a crucial design concern. The contract must produce objects that can enter and survive an enforcement flow.

Adaptive contracting, as a contract imaginary, alters the set of background assumptions behind safeguard contracting. The alterations relate to the environment of contracting. Essentially, the environment seeps in and disrupts the abstract, embedded, disconnected contracting imaginary in adaptive contracting.[20] First, the duration of contracts increases. The prototypical contract is no longer a single, discrete exchange. In adaptive contracting, contracts exist within a relationship. This relationship is made up of a succession of repeated and connected performances.

For example, a body shop delivers chassis components to an auto manufacturer. The exchanges are not discrete. Building manufacturing capacity requires sizable relationship-specific investments, which, in turn, require the purchaser to commit to the relationship for a time period that allows the body shop to recoup its investments. This entails that the temporality of contracts changes to incorporate successive cycles of performance, which are choreographed in advance. The contracts have to be able to govern exchanges that not only follow each other but also extend, possibly, quite far into the future. Here, the environment becomes relevant. It might change. With environmental variability, the interplay of the contract and environment becomes the focus of adaptive contracting. The contract must be flexible enough to accommodate changes in a dynamic environment. It cannot merely lock down futures; it must be capable of adjusting them if and when circumstances change.

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[19] Schepker et al., *supra* note 8, at 205–11; Ian R Macneil, *Contracts: Adjustment of Long-Term Economic Relations under Classical, Neoclassical, and Relational Contract Law*, 72 NW. L. REV. 854, 856–65 (1978).

[20] Schepker et al., *supra* note 8, at 212–13; Macneil, *supra* note 19, at 865–86.

Many adjustments appear in both contract practice and contract law.[21] On the one hand, contracts transform to include alternative futures. Neoclassical contract law allows the context to seep in to make the contract attentive to change. Relational contracts, in turn, establish rules that allow the contract to be adapted during its life. A contract internal approach is to resort to *complete contracting*, where parties attempt to anticipate possible contingencies and articulate multiple distributive outcomes for the eventualities they foresee. Complete contracting is, however, a fraught endeavor. The parties' foresight is limited. Costs also balloon as contract details increase. Complete contracting is, thus, often impractical and prohibitively expensive.[22] On the other hand, parties can devise processes and procedures where they themselves can adjust the contract to changing circumstances. Typical examples of such processes include, for example, hardship clauses, renegotiation, or third-party determination clauses.

### C. SOMETHING NEW: COORDINATIVE CONTRACTING

In coordinative contracting, a further and arguably more radical transformation in the contextual imaginary of contracting takes place. Here, assumptions change regarding the very nature of what business contracts are meant to govern. Whereas adaptive contracting is useful in managing relationships with successive cycles of discrete performances in a dynamic environment, coordinative contracting emerges when the boundaries between the contracting organizations become diffuse and porous and exchanges of discrete objects between black box organizations no longer exhaust the interaction between the parties.[23]

The first traces of coordinative contracting emerge with just-in-time production techniques. The relationship between a body shop and an auto manufacturer is again a helpful example. As the auto manufacturer thins out its warehouse buffers, the operational boundaries between the parties start to dissolve. Instead of successive deliveries on order, the contracting firms need to fuse parts of their operations together. They need a novel interface to articulate future order levels. The same applies to all other aspects of fragmented production, ranging from guaranteeing target market standards to

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[21] Several examples of these are presented for example by Macneil in his discussion of "neo-classical contract law," the rise of which he grounds in the realization that "classical contract law" does not provide an adequate basis for reflecting the inevitable contextual changes inherent in long-term contracts. Macneil, *supra* note 19, at 865–85.

[22] An opposite to a complete contract is *an incomplete contract*. Incomplete contract theory was developed by Sanford J. Grossman, Oliver D. Hart, and John Moore. *See, e.g.*, Sanford J. Grossman & Oliver D. Hart, *The Costs and Benefits of Ownership: A Theory of Vertical and Lateral Integration* 94 J. POL. ECON. 691 (1986); Oliver D. Hart & John Moore, *Property Rights and the Nature of the Firm*, 98 J. POL. ECON. 1119 (1990); OLIVER D. HART, FIRMS, CONTRACTS, AND FINANCIAL STRUCTURE (1995).

[23] Schepker et al., *supra* note 8, at 211–12; Macneil, *supra* note 19, at 895–905.

cost management, R&D, and sustainability governance throughout the production chain or network.[24]

As technological development accelerates and economic trends cause organizations to fragment, production structures become increasingly complex and interdependent, and coordination over organizational boundaries becomes a central aspect of production. These developments necessitate a radical shift in the sensibilities of contracting. Instead of articulating exchanges or devising mechanisms that allow the parties to redraw distributive outcomes, contracts need to govern production processes that are interdependent, fluid, and impossible to sequence, orchestrate, and even define as exchanges ex-ante. In practice, three types of provisions emerge.

First, coordinative contracting focuses on devising mechanisms for adjusting parties' actions to the actions of others. Complex performance in dynamic environments under fluid roles and interdependency conditions requires that information exchange channels are open and that all parties can constantly adapt their performances to other parties' actions and environmental changes. This close cooperation requires that organizations are capable of interoperation, not only cooperation. The organizations will often have to develop interlocking capabilities and operational structures, not just work alongside each other as separate entities. Thus, one key aspect of coordinative contracting is creating project organizations.

The basic organizational dimension of contracting is prominent, for example, in construction projects and service contracts. These projects often have boards, escalation procedures, and standing dispute resolution committees that effectively create a contract organization in the middle of and intertwining with the contracting parties. The organizational dimension is, however, becoming prominent in all kinds of production. Fragmented entities, such as value chains, cannot be competitive unless all value chain actors engage in quality control, cost management, R&D, and increasingly regulated sustainability governance.[25]

For example, in the case of value-chain-wide cost management, independent business entities in a supply chain may be tasked with sharing

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[24] For practical examples see Kajüter & Kulmala, *supra* note 7; LOCKE, *supra* note 6; Salminen, *supra* note 6.

[25] In addition to business reasons such as cost-management and R&D, public law is increasingly requiring value chain sustainability wide coordination from so-called lead firms not only for reasons of e.g. product safety but also, increasingly, for reasons of sustainability and security of supply. Generally, Jaakko Salminen, Mikko Rajavuori & Klaas Eller, *Global Value Chains as Regulatory Proxy: Transnationalising the Internal Market through EU Law*, in FOUNDATIONS OF EUROPEAN TRANSNATIONAL PRIVATE LAW (Anna Beckers et al. eds., 2024). For a recent regulatory example see Directive (EU) 2024/1760 of the European Parliament and of the Council of 13 June 2024 on corporate sustainability due diligence and amending Directive (EU) 2019/1937 and Regulation (EU) 2023/2859, 2024 OJ (L 1760).

cost information through "open books accounting" to provide a "value chain flow chart" that allows actors to identify and develop cost management on a case-by-case basis.[26] Furthermore, based on the flow chart, actors are expected to create sub-value-chain-level inter-organizational working groups that assess possibilities for cost-management unearthed by the value chain flow chart in more detail. This is in many ways similar to corporate group accounting, thus helping bridge the organizational gap between corporate groups and contractually organized supply chains.

Second, parties draft contract terms that articulate the roles they should perform under contract. Here, a subtle shift takes place. The contract does not articulate what a party is to do on an object level; instead, it articulates the actor space the party must fill. The actual, detailed duties emerge only when the context is known. A crucial change becomes visible: coordinative contracts articulate meta-level understandings of the framework for collaboration that serve as normative guidelines in identifying and allocating the detailed performances required of the parties.

To be sure, a classic distinction is made in contract law between contractual obligations intended to guarantee a fixed result and contractual obligations intended to ensure that a party undertakes its best endeavors to reach a particular result. The latter focuses more on giving a party a particular role, such as in the case of a doctor trying her best to save a patient without any guarantee that the patient can be saved. However, a doctor's role is very much predefined by her profession and expertise. In the case of coordinative contracting, it may be that only very general contours of a loose common objective can be predefined. Focus is less on one actor's superior expertise per se but, instead, on actors learning from one another what kinds of tasks can be expected from them and then utilizing this new, case-specific know-how to develop the project organization. The general objective becomes more precise only as the project organization develops. The result is a roster of fluid contractual roles that cannot be established ex-ante.

For example, as outlined in the case of value chain-wide cost management,[27] independent business entities in a supply chain may be tasked with sharing cost information to provide a cost-related value chain flow chart. This value chain flow chart may reveal possibilities for developing technologies and procedures for cost management on a case-by-case basis. The actors involved are not specialists in cost management per se but instead looking to learn from one another. Because of the uncertain, case-by-case nature of such a task, the starting point for any obligation to do so is that each supply chain actor commits to cost management for the benefit of the whole. This obligation can only be made more precise and explicit once the actors in

[26] Kajüter & Kulmala, *supra* note 7.
[27] *Id.*

the project organization learn from one another how they, together, can develop cost-management in the value chain. Numerous questions that traditionally would be set in precise contractual terms, such as specific measures for developing cost management and how ensuing profits are shared, cannot precisely be planned beforehand and must be left for case-by-case negotiations.

Third, as elaborate, advanced competencies are crucial to implementing complex performances, coordinative contracts contain provisions that seek to ensure that the parties have the capabilities to effectively pursue their common objectives. This entails, first, ensuring transparency about the capabilities of actors and, then, if such capabilities are found inadequate, mechanisms of capability building whereby one actor helps others to develop their technical (or other) capabilities.

Ensuring competencies is not simply about pre-screening actors to comply with expected standards. The costs of replacing actors already integrated into a value chain may be higher than developing their capabilities when faced with new value chain-wide production requirements, such as implementing new processes, technologies, or regulations. This requires constant value chain monitoring and mechanisms that ensure actors receive assistance for upgrading their capabilities. Again, the result is a tightening integration of the project organization beyond organizational boundaries, with the very objectives of the project organization becoming the focus of ensuring and developing the competencies of participating actors.

To return to the example of value-chain-wide cost management, the very objectives of the project organization become the focus of ensuring and developing the cost-management competencies of participating actors.[28] The value chain flow chart and inter-organizational working groups discussed above ensure transparency about actors' capabilities and developmental possibilities. Developing these capabilities, then, becomes a matter of sharing knowledge about relevant processes and technologies and ensuring that actors have the financial and other means of implementing them in practice. It becomes a matter of ad hoc factual interaction beyond organizational boundaries.

To sum up, from a legal point of view, the challenge of coordinative contracting resembles those encountered in adaptive contracting, just on steroids. This is, finally, where the breakdown occurs, and standard contract theories, ultimately, break apart as explanatory devices. They offer little to make sense of coordinative contracts. Classical contract law perceives a plethora of obligations and, in a ham-fisted way, would move to enforce them all to the fullest extent. Neoclassical contract law would give the obligations a nuanced, contextual reading and then offer to enforce them. In both cases,

[28] *Id.*

the binary code of contract that is only capable of discerning binding, enforceable obligations or unenforceable non-entities misses important dimensions of these new contractual tools. Relational contract law would, perhaps, recognize the obligations as relationship management devices and acknowledge that the standard enforcement avenue might not suit them. At the same time, TCE scholars would marvel at the differentiated and refined way in which the firms manage the cross-cutting incentives but shrug their shoulders when confronted with the question: are these really contracts? Contract law theory, thus, struggles to identify and recognize the particular modalities through which such clearly coordinative provisions affect the parties.

The common law doctrine of certainty is a case in point. For decades, the doctrine entailed that "agreements to agree" lacked legal significance and were unenforceable. Any agreement to negotiate and arrive at an amicable resolution of a dispute in, for example, structured negotiations or within a mediation framework was a contractual non-entity. If a party refused to abide by an agreement to negotiate in good faith or to mediate, courts could not force it to do so. Over time, courts have learned to give meaning to and enforce mediation agreements. In relation to coordinative contracting, a similar learning process is no doubt required: should we translate what are, from a traditional contract law perspective, uncertain obligations, such as vague commitments to overarching objectives and loosely assigned actor roles, with or without factual interaction beyond the four corners of a contract, into legal duties and how?[29]

In a seminal work, Gunther Teubner proposed an approach to dealing with relationships arising in complex networks.[30] In his view, a "network" is identified by contracts that refer to one another and where an overarching network objective, such as cost management, can be identified. Any legally relevant relationship in such a network, however, would in practice derive from the *ad hoc* interaction between actors within this network and could potentially sound under a variety of legal bases including, but not limited to, different theories of contract and tort depending on circumstances and applicable law. Reflecting this jurisdiction-dependent diversity of possible legal foundations, our focus here is not on identifying a particular legal foundation for coordinative contracting. Instead, we focus more on explaining the multiple practical modalities of using contracts to coordinate production:

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[29] This seems to be the crux of many recent business and human rights related cases, such as Doe v. Walmart, 572 F.3d 677 (9th Cir. 2009); Chandler v. Cape [2012] EWCA (Civ) 525; Das v. George Weston, [2017] ONSC 4129 (Can.); Jabir and Others v. Kik Textilien und Non-Food GmbH, 7 O 95/15 (Landgericht Dortmund) (Ger.); and Lungowe v. Vedanta [2019] UKSC 20.

[30] GUNTHER TEUBNER & HUGH COLLINS, NETWORKS AS CONNECTED CONTRACTS (2011).

what is the role of contract in assigning network roles and objectives, and how should theory reflect these new uses of contract?

## IV. FUNCTIONAL THEORY AND CONTRACTUAL PRACTICE: A CASE ANALYSIS

### *A. From Equipment Manufacturer to Value-Based Solution Provider: Case Gamma*

Some years ago, we partook in an explorative, action-research project where the research team observed and attempted to help a listed company (Gamma) division develop a new business model.[31] The company aimed to transform how it sold its offering. It had been a global logistics equipment manufacturer that delivered its products to its customers worldwide. Now, the company wanted to become a solution provider and sell not only products but also design and maintenance services. The company's product offering was top-of-the-line and unrivaled in reliability. In addition to selling the products, the company also designed the installations. The combination of reliable products and design competence offered the company's customers a combination that significantly boosted the customers' value-generation capacity over what the company's competitors offered. The problem was that the company was failing to capture a premium price for its offering. It competed in the product business in terms of price. In a worst-case scenario, the company might answer a request for an indication of interests, design an installation plan, disclose it to the customer, and find itself two months later bidding for a product delivery contract specified to the plans it had drawn. To capture some of the value of its design competence and motivate its premium prices, the company sought to transform into a solution-oriented company and transition to selling value-generation capacity to its customers. This required a new value-based selling and pricing approach. The company was determined to market its products by telling customers how much added value its offering would generate and justifying the premium price by the additional value it created. Ultimately, the aim was that the premium would be set at a fraction of the added value the platform generated over the company's competitors' offerings.

In the first stage, we were confronted with an acute contract drafting problem as lawyers and legal scholars. The company needed a contractual template for pricing the offering using value-based pricing principles. The idea was to develop a computational model for determining the added value the new platform created for the customers and then to articulate the model in

[31] Johanna Liinamaa et al., *Performance-based and Functional Contracting in Value-based Solution Selling*, 59 INDUS. MKTG. MGMT. 37 (2016).

a contractual provision. This task soon proved extremely challenging. The value function of the offering was incredibly hard to formalize in the legalese of contracts. It had far too many moving parts: the value depended not only on platform usability, reliability, and the quality of the services provided but also on the stage of the industry business cycle, the client's proficiency in using the platform, and to an extent, sheer chance.

The only way forward seemed to be to develop an institutional framework for determining the value *ex-post*, after all the uncertainties had played out, not *ex-ante*, as a set formula. This approach could disambiguate the messy and contradictory drivers of value formation. In practice, the pricing approach would have to build on a battery of simulation techniques. The added value over competitors' offerings could be determined by simulating how the competitors' products performed and comparing that simulated added value to the actual added value the solution generated.

This approach soon ran into problems. Running the simulations required that the company and its customer exchange information on the actual performance of the platform and have adequate trust in each other to rely on the mechanism. Once a provisional template was in place, the first customer meetings proved challenging. Customers were suspicious of the new pricing model. They had never seen anything like it and struggled to understand the contract templates.

The problem was compounded by product characteristics. Remember that the company tailored its product installations to match each customer's specific needs. This required that the company access information on its customers' business processes and the physical infrastructures to which the products were to be installed. At the same time, demonstrating the platform's value required the company to disclose the platform's design outlines. This was a sensitive issue. Remember that the company lost several deals when its customers used the company's designs opportunistically as templates for new detailed requests for quotes. This posed a serious problem as disclosure of the plans was unavoidable under the new sales approach.

To overcome these challenges, the company developed a novel negotiation and sales process in addition to the new business and contract models. This negotiation and sales process is presented next.

### B. THE FUNCTIONAL CONTRACTING PROCESS

The functional contracting process aimed to use *contract-like devices* to support early cooperation and *coordination* between the company and its customers. Early cooperation was of primary importance because only through such cooperation would it be possible to reach an agreement over pricing in the first place. Cooperation, in turn, required coordination already during the negotiations.

The functional contracting process differed from the company's usual sales process. The intention was to use a series of signed Memoranda of Understanding (MoUs) that were intended to codify the parties' terms of cooperation. The MoUs were not meant to be binding, enforceable agreements. They were not strictly speaking contracts, but they did contain several terms that were intended to be strongly binding and thus were directly coupled to legal enforcement mechanisms; for example, the terms related to prohibiting the use or assignment of information gained from negotiations.

Otherwise, the effectiveness of the process was based on other than enforcement-based legal mechanisms. For example, the enforcement value of the terms in the very first MoU was low. The terms were intended to provide a framework for the negotiations: the parties, first, agreed to negotiate in good faith and with the intent to reach a specific kind of an agreement, and, second, committed to immediately inform the other party if it became clear that an agreement would not be reached. At the same time, the terms allowed either party to terminate negotiations at will. Crucially, the MoU was silent with regard to the effects of its breach: such repercussions were intentionally left outside the MoU.

This leads us to the trail of the planned effectivity mechanisms for the interventions. On the one hand, breaching the binding portions of the MoU would constitute a classic breach of contract that could potentially have its normal repercussions, such as a duty to cure the breach or pay damages for any costs incurred due to the negotiations. On the other hand, the MoU might give a breaching party an idea of a court holding the MoU as a contract, and doctrines such as *culpa in contrahendo* or *promissory estoppel* could potentially impose penalties on it. Both scenarios, however, were rife with uncertainties. For example, showing the breach and the quantum of damages would certainly prove challenging in a court of law. These uncertainties contributed to dissolving the enforceability of the MoU. Its obligational content was not strong from a safeguarding perspective.

Nonetheless, we opined that the MoU would serve a purpose. First, we assumed that by engaging the register of legal enforceability aimed at law and lawyers, the company might be able to gain important information on the aims and motives of its customers. If a customer refused to sign the MoU, it seemed probable that they were not willing to consider new ways of doing business with the company.[32] Thus, there was no reason to continue pouring additional resources into the negotiation process with such customers. Second, the MoUs created a document trail that could be used in a later phase to structure the

[32] At the same time, legal-cultural contexts are diffuse in international trade and thus simple conclusions should be avoided. For example, apparently for legal-cultural reasons European and US companies were unable to agree on a unified solution to work safety in Bangladesh. Salminen, *supra* note 6. For the role of cultural factors more generally, see LOCKE, *supra* note 6, at 102–03.

parties' relationship and as a weapon in future negotiations.[33] Third, we intended to use these formalistic MoU interventions to resuscitate an earlier culture of gentlemen's agreements.[34] The company felt that contract-like MoU documents, reflecting the force of ink-on-paper, would be a suitable means of staving off unethical behavior.

Other means of influencing customers were related to marketing and the strategic control of organizations. In the company's business sector, engineers were typically responsible for purchasing. Contracting models were also very much established. The company, however, was offering a new contract model. If the contract model was sold to engineers and only considered by the customer's executive and legal functions late in the process, the situation might be dangerously volatile. Investment decisions would likely be delayed while lawyers acquainted themselves with the new contracting model. In the worst case, all efforts would be pointless if the customer's upper echelons would not accept the new contracting model.

Thus, involving a customer's executive and legal functions from the start of the sales process seemed essential. As legal documents requiring commitment, the MoUs would increase the probability of this happening early on. It is important to note that the company used the MoUs to affect the internal processes of the customer's organization, i.e., manage them through specific interventions specifically aimed at particular sub-entities *within* the customer organization's corporate black box instead of the customer entity itself. This management function extends also to the company's own organization.[35] MoUs were integrated as performance indicators into the guidance program of sales personnel. They were then used to track the progress of the sales negotiations.

How did the case study fare? On a practical level, not too well. For a variety of reasons, the company did not go far with its new business model. On a contract-theoretical level, however, we think that the case study provides a nascent template for thinking about contracts. This template satisfies the requirements we set above in Section III for a new, more functional understanding of contracts and contracting, as discussed next.

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[33] For the documentary function of commercial contracts, see Thomas Dietz, *Contract Law, Relational Contracts, and Reputational Networks in International Trade: An Empirical Investigation into Cross-Border Contracts in the Software Industry*, 37 L. SOC. INQUIRY 25 (2012). Hurmerinta-Haanpää and Viding use the term "codification function" to refer to a similar function. See Anna Hurmerinta-Haanpää & Sampo Viding, *The Functions of Contracts in Interorganizational Relationships: A Contract Experts' Perspective*, 4 J. STRATEGIC CONTRACTING & NEGOT. (2019).

[34] *See generally* Macaulay, *supra* note 10.

[35] On the internal management function, see Hurmerinta-Haanpää & Viding, supra note 33, at 108. See also ANNA HURMERINTA-HAANPÄÄ, THE MANY FUNCTIONS OF CONTRACTS – HOW COMPANIES USE CONTRACTS IN INTERORGANIZATIONAL EXCHANGE RELATIONS (2021), at 79.

## V. LESSONS LEARNED – THE IMPLICATIONS OF FUNCTIONAL CONTRACTING FOR CONTRACT THEORY, LAW, AND PRACTICE

### *A. Contractual Multivalence*

First, our experiment demonstrated that a single contract document can be used simultaneously with multiple aims and to pursue multiple objectives. The contract-like interventions implemented had no single standard purpose, which is also reflected in other research.[36]

Nevertheless, none of the MoUs were contracts in the traditional sense. They were not binding, and most of the obligations they created were extremely weak in terms of the standard safeguarding and enforcement imaginaries. It would have been extremely hard to go to court and enforce them. The MoUs, nevertheless, engaged and co-opted contract-like and contract-related effectivity mechanisms. The firm used contract law to do things with entities that were not full-blown contracts. The contractual tools had other purposes that the company executives deemed potentially useful. Securing rapid, reliable enforcement was simply not the point of these contractual tools.

This contractual nature of non-contract devices provides the animating impetus for our theoretical thinking. Our insistence on the "real" binding, enforceable contracts hides the polyvalence in how firms use contracts and the multiplicity of contractual devices. We contend that we should start re-outlining contract theory, keeping in mind that contracts may be best understood, enacted, and performed as multifunctional, multivalent entities with varying effects and incorporate many technological devices seeking to attain those effects. This is in stark contrast to the traditional approach seeking to identify a primary objective for individual contract types, such as sales, lease, mandate, enterprise, or dispute resolution contracts.

On a practical level, this change has emancipatory consequences. The sky is the limit for creativity in contract design. New opportunities emerge for contractual design and use if contracts are understood as multifunctional and multivalent entities. The primary question changes shape. We are no longer confined to asking what contracts can do. Instead, we can start exploring what we can do with contracts. Suppose one can identify a contractual technique to latch onto a legal contractual register of meaning. In that case, the technique may be worthwhile even if lawyers would not recognize the instrument as contractual per se.

Here, a forceful counterargument opposed our theories. We recognize that the MoUs were not "real" contracts, but we disagree with the conclusion that

[36] *See* Kajüter & Kulmala, *supra* note 7; Dietz, *supra* note 33.

is often drawn. Scholars who argue that these kinds of instruments should not be conceptualized as contracts are wrong. If we understand that contracts as legal instruments have a fixed core—a roster of faculties and characteristics that must be present to satisfy some transcendent standard of "contractness"—the MoUs clearly failed the test. They were, in this sense, non-contracts, something else. However, these instruments had a close affinity to contract law, and its meaning and effect flows. Therefore, it makes sense to talk about them as "contractual instruments." These "artifacts" had a close connection to contract law; they had the power to call upon the networks triggered when a contract entered the arena. Consequently, in our contract imagination, they are contractual instruments, and we should recognize their contract-like valences and characteristics as contractual.

### B. THE SCALE OF CONTRACTS

Second, the experiment demonstrated that a "contract," as a single monolithic entity, resides on the wrong topological scale as the key concept of a contract law imaginary. A contract is far too big, cumbersome, and heavy, with too many moving and inert parts. It has too much baggage.

The contractual technologies that functional contracting deploys are not monolithic, full-blown, giant things. Rather, they are smaller entities. We came to conceptualize them as *contractual intervention techniques*, as instruments that attach to and leverage contractual effectivity networks yet often fall shy of meeting the core standards of the traditional contract imaginary. These intervention techniques allow their users to affect the world but do not require them to strike grand bargains or outline choreographies of performance for the entire course of a transaction. Contractual intervention techniques can work on the microscale, affecting discrete issues with their custom-built levers.

Thus, when thinking about contracts, small should be beautiful. This point was driven home by the MoUs. Some of the MoUs could be characterized as real traditional contracts as well. They contained strict obligations binding the parties, such as not disclosing design materials to third parties or utilizing them outside the sales process. However, the company did not view these "real" and "hard" obligations as the most important aspects of the MoU in which they were contained. They would be very difficult to enforce and had little promise in terms of their likely effects. On the contrary, the hard obligations were incidental backup mechanisms to provide a last line of defense against opportunistic customers. The most important dimensions of these interventions were small-scale manipulation attempts that sought to, for example, open up an organizational interface between the parties. The "hard" obligations also had another purpose. They were there to trigger a response by the customer legal departments; when a hard obligation arose, the

customers would need to discuss it with their legal departments, who would likely then become aware of the new contract model designs as well.

However, it is important to note that we do not argue that all contracting only resides on this microscopic scale of small-scale, individualized interventions. The small-scale interventions can and most often are collated into a *series* of interventions, which together amount to or even extend beyond the comprehensiveness of a traditional contract. Nonetheless, it seems crucial to recognize the composite nature of contracts and not view the complex, multivariate, multipurpose contracts as aberrant. All complex contracts are bricolages.[37]

### C. FOCUSING ON EFFECTIVITY OF MECHANISMS

Third, the scaling down of contracts into a series of contractual interventions accentuates the need to recast our contract law imaginary of contracts as objects, as artifacts. In the traditional contract law imaginary, contracts are textual entities that consist of provisions and clauses. The individual provisions and clauses are the smallest constituent objects of a contract in this imaginary. These textual objects, then, create rights and duties for the parties. The rights and duties enter enforcement flows, but what happens to them and what material, real-life effects the rights and duties have is an afterthought.

This textuality and rights-orientation of the contract imaginary have consequences. We lose sight of the components of contracts that ensure and tailor their effectiveness. We only see and problematize the rights and duties contracts create, but we do not inquire into the mechanisms that transform those textual objects into real-world changes. In our current imaginations, the mechanisms are unimportant, parts of a legal infrastructure that is assumed to be there.

There is ample reason to change the perspective and reconceptualize contracts. Take any standard boilerplate contract as an example. These contracts simply do not attach to and mobilize the standard default effectivity mechanisms the legal system provides. Instead, the parties always adjust the effectivity mechanisms in some fashion, often drastically. State courts are typically eschewed in favor of arbitration or coupled with tailored mediation or conciliation by way of dispute resolution clauses. Parties limit the application of the default statutory liability regimes, modify their details, establish contractual limitation periods that alter the temporality afforded by default rules, and parties often design entire machineries of incentives and sanctions to prod them into desired performance.

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[37] A poignant example is provided by MITU GULATI & ROBERT E. SCOTT, THE 3 1/2 MINUTE TRANSACTION: BOILERPLATE AND THE LIMITS OF CONTRACT DESIGN (2013).

These and other modifications to contractual effectivity mechanisms are key to understanding how contractual intervention techniques should be conceptualized. To address the blindness to how contracts gain their effects, we suggest that we decontextualize our contract imaginaries, meaning that we relinquish our focus on understanding them as texts. Instead, we should functionalize contracts.

In a functional understanding of contracts, a contract becomes a fusion of what determines its ability to create real-world effects and the symbols that articulate those real-world effects. We should understand contracts as combinations of legal outcomes and practical effectivity regimes.

This gives a new outline to a contract. A contract is a device that consists not only of the legal objectives, i.e., articulations of the desired outcomes as to the rights and duties the contract is created to afford parties but also of the effectivity mechanism through which whoever stages an intervention thinks any "rights and duties" will translate into meaningful real-world outcomes.

What the effectivity mechanisms are is the crucial question. We have grown accustomed to thinking that enforcement is the only real register for contracts. However, there are countless other possible mechanisms parties may try to use. A party might try to create a compromising paper trail that could become an asset in an eventual court showdown. Similarly, the solemnity of imprinting signatures on paper, the presence of lawyers, the ensuing "juridification" of the relationship, or the *moral* weight of an agreement all potentially affect the parties and influence their actions. These effectivity mechanisms potentially work and should not be discounted merely because they do not fit the traditional image of binding contracts.

The choice and articulation of the effectivity mechanism emerge as the crucial choice of contract design. Contracts combine duties and rights with the mechanisms that translate these into real-world effects.

### D. REAL MULTIVALENCE

Fourth, contracts emerge as synchronously multivalent, plural instruments composed of divergent mentalities, approaches, and technologies in the new imaginary. A contract is better described as, in fact, containing multiple different contractual interventions that sequence and combine multiple contracting modalities and technologies. Crucially, these contract valences lack a hierarchical center. There is no "real," "primary" valence. Instead, the different valences emerge and are useful in different aspects of the relationship.

Take an example: a long-term cooperative manufacturing contract.[38] In the contract, the parties negotiate a framework for a succession of deliveries but also establish procedures for managing warehouse levels, communicating lead times and changes in both parties' circumstances, requiring and scheduling R&D-investments, and implementing measures for driving down unit costs. It seems fairly clear that the contract performs and enacts, in fact, at least two fundamentally different types of relations. The contract aspects that deal with the deliveries likely perform a very traditional approach to contracting and the parties' relationship. The parties need to set out the logistics and payment details and cast in stone a liability framework for defective deliveries and other breaches of the contract. This will be a natural province for traditional hard safeguard contracting.[39]

The contract aspects that relate to flexible coordination between the parties tell a different story. Here, the relationship is more fluid and less focused on object-bound rights and duties. Correspondingly, a different approach should be required in relation to both contracting mentality and effectivity mechanisms. Where threats of enforcement, termination, monetary incentives, and sanctions likely will serve the needs of the safeguarding aspect of the relationship well, they may be counterproductive and even destructive in the coordination aspect. Instead, for coordination, the parties need a radically different approach to making the contract effective. They will probably need to build a relation-specific temporary organization capable of making decisions, addressing and resolving problems and, ultimately, deciding when to abandon efforts and start dissolving the relationship.[40]

As mentalities and effectivity mechanisms differ, contract design should as well. The impregnable legalese of exhaustive definitions, precise language, clarity, precision, and enforceability may fit well with contractual interventions aimed at safeguarding interests. However, doing so in relation to the other aspects of the relationship might suffer from over-juridification and over-lawyering. Different contractual interventions serve different communicative and enunciative purposes, triggering a need to tailor the texts and other contractual artifacts to serve the purposes of each need.

Thus, the imaginary of a unitary contract devolves into competing imaginaries that differ radically in their internal composition and thrust. However, it seems ill-advised to argue that one approach, mentality, or set of effectivity mechanisms would be dominant. They just coexist and, at times, interfere. The challenge is coordinating and fitting together these different "contracts" and their concomitant mechanisms.

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[38] Compare, for example, the scenarios provided by Kajüter & Kulmala, *supra* note 7, with Omri Ben-Shahar & James J. White, *Boilerplate and Economic Power in Auto Manufacturing Contracts*, 104 MICH. L. REV. 953 (2006).
[39] Ben-Shahar & White, *supra* note 38.
[40] Kajüter & Kulmala, *supra* note 7.

### E. BEYOND ENTITIES AND PRIVITY

Fifth, the idea that contracts consist of small-scale intervention technologies that can collate into a series provides a clue to understanding how firms use contracts to govern production networks beyond entity and contractual boundaries. The traditional enforcement imaginary locks contracts to work within the boundaries of privity by connecting specific entities together. Contracts can only be binding on their signatory organizations.

However, the functional contracting imaginary is agnostic to the actors that the contractual interventions target. For example, any actor *within* a party can become an intervention target. In our case study, the MoUs targeted, for example, technical purchasing officers, the legal department, or the customer board, seeking to affect their behavior. Thus, contracts operated on a sub-entity, sub-privity scale. They did not seek to affect the signatory as a black box organization. They sought to affect specific components of the entity in question.[41]

The effect is similar on a supra-entity, supra-privity scale. Contractual interventions may attempt and often manage to affect parties that lie beyond the boundaries of privity. Take the Bangladesh Accord as an example. The Accord seemingly establishes binding obligations only on its Global North signatories, a host of global textile brands, and global unions. Nonetheless, the contractual tools the Accord deploys muster resources to improve labor conditions on the ground by sustaining in-country audit organization and instituting a complex and expansive regime for identifying and addressing shortcomings among several tiers of non-privy suppliers in different supply chains and their respective employees. The crucial difference to prior imaginations is in the inherent flexibility of the approach. If the contractual interventions are capable of evoking changes, they do.

### F. THE ROLE OF LAWYERS

Sixth, these changes in understanding contracts bring about a crucial transformation in relation to the role that lawyers play in designing and implementing contracts. Traditional understandings of contracts have held lawyers in charge of safeguarding interests identified by others. Lawyers understand contract law and contractual practice, know the restrictions and possibilities offered by different contractual terms, and are adept at a strategic game of safeguarding one's back in case things go wrong. Lawyers know how to make contracts unambiguous (or, if necessary, ambiguous), as watertight, and often as complex as possible while bleaching awkward details and the chaos of the real world out of sight. Negotiations typically lead to a document that is perfect as a textual artifact. The other side of the equation, however, is

[41] Conversely, access to whole entities can be blocked by diverting parties away from crucial components, as described by Ben-Shahar & White, *supra* note 38.

problematic. The document may, in practice, have little to do with the contractual relationship it is meant to reflect. The document is prepared given potential disputes.

An oft-heard complaint is that lawyers are not conducive to business interests. They just keep on saying "no." Introspection provides possible reasons for this image: lawyers both instinctively are and are trained to be careful and risk-averse. Incentivization is also problematic. For a lawyer, it is safe to err in the direction of safety. Lawyers have no sales target and a minimal loss budget. From this perspective, a transaction that never leads to losses because a lawyer has taken no risk is better than an otherwise good transaction that falls through due to a legal failure and results in loss. The position of legal counsel in an organization and its work and information flows is another point of contention. Lawyers tend to be involved in negotiations in a late phase, often when commercial terms have already been agreed upon. At this point, it may be difficult to tear open the result of negotiations. Thus, there are two possible answers: yes or no.

Through functional contracting, a lawyer's skill set is inevitably expanded. The purpose of the legal function is to support businesses and develop solutions to business problems, beyond preparing for the termination of a relationship and the final settling of accounts. This change highlights the role of business know-how. As has been repeated for decades, a lawyer must know the business a contract is part of. In functional contracting, this requirement becomes ever more pronounced. When a company considers ways to influence its customers and how to govern a relationship through contract, even lawyers have to understand how different organizations function and operate, which actors are in bottle-neck positions, what are the strengths, weaknesses, and limitations of actors, where potential problems are located and how to react to them, and what are each party's leverage and sore points. Lawyers should provide contractual instruments that provide creative answers to business problems, not merely codify solutions created by others.[42] This becomes all the more difficult as it needs to be done on the basis of incomplete information, particularly concerning a customer's internal organization. This new role of lawyers is bound to change, as well as legal training and education.

The tight integration of legal functions into other business processes and strategic design becomes a prerequisite for a successful business. Lawyers

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[42] This change in lawyers' mindset is discussed in many studies embracing proactive contracting approach. *See, e.g.*, PROACTIVE LAW IN A BUSINESS ENVIRONEMENT (Gerlinde Berger-Walliser & Kim Østergaard eds., 2012); Helena Haapio, *Next Generation Contracts: A Paradigm Shift* (2013) (Ph.D. dissertation, University of Vaasa) (Lexpert); Jouko Nuottila et al., *Proactive Contracting: Emerging Changes in Attitudes Toward Project Contracts and Lawyers' Contribution*, 2 J. STRATEGIC CONTRACTING & NEGOT. 150 (2016).

must participate in and be aware of preconditions, objectives, and actors already in the early stages of business processes, preferably when business relationships are construed. Functional contracting requires that lawyers know in what context and on what terms business is being developed.

The traditional approach is to have lawyers join negotiations from the onset. An alternative approach is to develop a company's processes so that legal expertise is structuralized within them. Legal counsel would be present when business models are planned, sales processes are developed, management systems are built, and back-office functions are organized.[43] Legal expertise would be ever-present, and scarce legal resources could be activated at the right moment.

At the same time, it is clear that functional contracting and lawyers need not be *literally* ever-present. All contracts do not need to be planned or negotiated from the perspective of functional contracting and its methods, and each contract does not need to contain adaptive or coordinative mechanisms. A simple sale is a simple sale, a project a completely different story, as is the governance of a transnational supply chain. Different contexts require different legal interventions.

Functional contracting also encourages non-lawyers to understand that contractual interventions can be strategically important for businesses. Instead of asking lawyers to "do their stuff" once everything else is done, they can be expected to help with practical problems. Specific contractual techniques may be available to respond to diverse challenges, increasing the probability that an actor reaches its objectives.

## VI. CONCLUSION – THE PARADIGM-CHANGING POWER OF FUNCTIONAL CONTRACTING

Firms use a wide variety of contractual tools to coordinate their relationships in complex production networks and in relation to a diverse range of transactions that are not easy to codify into classical contracts. As contract lawyers and scholars, we lack the intellectual resources, concepts, and theories to understand these tools embedded in contracts. The enforcement-centric, safeguarding-focused contractual paradigm of yore dominates our contracting imaginaries. We struggle to give meaning to those contractual tools that fail to have significance under the old paradigm. The things that the traditional conceptual apparatus fails to account for are, for law, simply not contracts.

We think that the old approach is wrong and counterproductive. As outlined above, any new theory is to overcome at least three sticking points in current contract theory and practice. First, the new way of thinking about

[43] Ivar Timmer, *Changing Roles of Legal: On the Impact of Innovations on the Role of Legal Professionals and Legal Departments in Contracting Practice*, 2 J. STRATEGIC CONTRACTING & NEGOT. 34 (2016).

contracts should be able to deal with ambiguity by accommodating contracts that do not fix duties and rights ex-ante. Second, the new way of thinking about contracts would have to recognize that enforcement is not the only possible imaginary through which contracts gain effectiveness. Third, the new way of thinking about contracts would have to cope with actor and audience multiplicity and complexity, whether between several tiers of entities or within individual entities themselves.

We have illustrated how recent contract theories, such as TCE and relational contract theory, address some of these questions. Overall, however, they fail to account for the multiple uses of contracts in today's fragmented production structures, such as production networks and value chains. We propose using *functional contract theory* to help bridge the gap between contract theory and today's business practices. To illustrate how functional contracting can be applied in practice, we presented an example of a functional contracting process developed in an explorative action research case study for a company that struggled to transition from an equipment manufacturer to a value-based solution provider.

We hope the case study illustrates the change in contractual imaginaries entailed by functional contracting. This has implications for contract theory, law, and practice. First, the effectivity mechanisms of contract have greatly diversified from the traditional legal-theoretical focus on the pre-emptive safeguarding of legal rights. This coincides with a change in scale from contracts understood as monolithic codifications of transactions towards understanding contracts as a series of individual interventions within transactions. These developments lead to the liberation of contract theory, firstly by placing focus not only on the law itself but also the manifold extra-legal (or, perhaps, *not-yet-legal*) effectivities of contract and, secondly, by placing these different effectivities on even footing in relation to one another.

The resulting multivalence of contractual effectivities inevitably leads to the partial dissolution of existing categories of legal entities. Contractual techniques are used to affect not only "parties" in the traditional sense, but also, for example, actors beyond privity in multitiered production networks or particular sub-entities nested within corporate boundaries instead of the corporate black box as a whole. This, in turn, leads to a new strategic role for contract lawyers as instrumental actors in devising solutions to the needs of management, both within and without organizations. The end result is that contracts are no longer merely legal devices drafted by lawyers for lawyers to view when terminating a relationship.

As with all legal developments, it will no doubt take time for the new imaginaries to be understood by the law itself and given premeditated legal meaning. At the same time, any lack of such meaning does not make the techniques of functional contracting meaningless. On the contrary, a lack of fixed legal meaning may even allow for their more creative use in

coordinating actions within fragmented entities, as is already being done with instruments such as the Bangladesh Accord and open books accounting in contractual supply chains.