Planning for Bargaining Power

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Albert H. Choi & George G. Triantis, *Designing Contract Modification*, __ **U. Chi. L. Rev.** __ (forthcoming), available at SSRN (Feb. 02, 2025).

This article by Professors Choi and Triantis hits close to home with how closely it models my personal experiences with oil and gas leases on my family's farm during the leasing boom of the early 2000s. Specifically, the authors explore how parties can structure long-term contracts to maximize the expected value in the face of uncertainty regarding changes in relative bargaining power that may occur over the term of the contract by designing the contract to permit modification even if that modification merely redistributes the available surplus.

Beginning in about 2008-2010, discoveries in the Utica shale formation stretching from Quebec, Canada, down through Eastern Ohio, together with improved fracking techniques, led to a new oil boom.[1] I assisted my uncle in negotiating a lease for his farm. Based on oral histories of prior experiences, we were reluctant to enter long-term leases without substantial protections against exploitative dealings over the term of the contract. By delaying, we were able to wait until we had more bargaining power as demand for new oil & gas leases increased, and eventually my uncle executed a lease on substantially better terms than the early-moving neighbor. On the other hand, by delaying, we also missed out on almost two years of royalty payments.

This choice between contracting early to avoid later uncertainty versus "wait-and-see" to avoid potential exploitation is the situation addressed by Professors Choi and Triantis in *Designing Contract Modification.* Facing uncertainty regarding both future changes in bargaining power affecting either party and facing uncertainty regarding good faith, willingness to breach, and statutory impacts on party bargaining power, how should parties contract to maximize the available surplus? Can the parties structure their contracts to promote the willingness of the parties to contract earlier in the transactional process despite uncertainties regarding future changes in party bargaining power? More importantly, should courts respect later contract renegotiations and modifications resulting from changes in party bargaining power, even if those changes are merely redistributive and do not result in any increase in total contract value? Professors Choi and Triantis answer these questions with a welcome take on the dynamic nature of bargaining power, not just at the moment of contracting but also over the course of the parties' transactional relationship.

The authors describe the central problem in terms of "the parties' flexibility to modify [contract] terms and its effect on their earlier contracting decisions." (P. 2.) Renegotiation and modification of long-term contracts provide potential benefits in terms of re-aligning party rights and obligations in light of developments after contract execution, but also carry the risk that one party may exploit changes in bargaining power after contracting solely to extract a greater share of the bargaining surplus. As the authors note:

> A modification of a contract can be valuable in promoting *ex post* efficiency—revising contractual obligations so that they are optimal in the (ex post) realized state of the world. Renegotiation, however, may be hazardous to *ex ante* efficiency because it presents an opportunity for one contracting party to "hold up" the other, who has made relationship-specific

> reliance investments. Renegotiation can further undermine ex ante efficiency if it upends the parties' efficient allocations of risk. (P. 2.)

Professors Choi and Triantis begin by recognizing the reluctance of courts to enforce ex ante modifications that solely redistribute the contractual surplus. (Pp. 2-3.) They survey the "tortured path" taken by courts wrestling with doctrines surrounding contract modification (P. 7), including the pre-existing duty rule at common law, as well as the doctrine of good faith,[2] duress, and the Restatement (Second) of Contracts § 89 requirement that modifications be "fair and equitable." (*See* Pp. 7-13.) With this base, the article moves to a brief description of the economics of contract renegotiation, noting that renegotiation has been viewed as either ex post efficiency enhancing (as where changed circumstances permit the parties to expand the transactional surplus through modification) or ex ante efficiency reducing (as where the threat of later modification reduces a party's willingness to make relationship-specific investments). (Pp. 13-15.) In particular, as described in the next section, exogenous factors over the course of a long-term contract may significantly alter the relative bargaining power of the parties such that one party may demand renegotiation of the contract.

This recognition of the dynamic nature of bargaining power is what I found compelling about this article. To the extent that courts address relative bargaining power at all, they tend to focus solely on the moment of contracting and not on whether a party could have made bargaining power-related investments before contracting. Professors Choi and Triantis examine things in the other direction, observing that both exogenous and endogenous inputs may affect relative bargaining power over the contract term. (Pp. 15-16.) Focusing on exogenous inputs affecting bargaining power, the authors continue in the following sections with a series of models demonstrating that contracts structured to promote good faith or fair and equitable modifications in the face of such ex post shifts in relative power. Specifically, Professors Choi and Triantis present a compelling argument that parties should be more willing to enter contracts where they anticipate uncertain shifts in bargaining power caused by exogenous events by designing the contract to promote modifications through terms such as deliberately under-compensatory liquidated damages clauses and obligations to renegotiate in good faith. (Pp. 29-30.) In such cases, even if the modification is purely redistributional, the expected value to the parties and the willingness of the parties to make relationship-specific investments will be increased compared to situations in which such modifications are unavailable or unenforceable. This is a great article that explores the modification doctrine in a way courts rarely consider.

1. *See* Forest Oil To Develop In Quebec, **Hart Energy** (Sept. 9, 2008); Olga Popova, *Utica Shale Play: Geology Review*, **U.S. Energy Info. Admin.** (April, 2017); Bob Downing, *Three-state Appalachian Basin with Utica, Marcellus Shales has Become No. 1 U.S. Source of Natural Gas*, **Akron Beacon J.** (May 14, 2016).
2. *See* UCC §§ 2-209(1) and 1-304.

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