

The Role of Nonprofits in the Production of Boilerplate

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I. Introduction

Drafting contracts requires investments of time, experience and ingenuity. Those investments may yield significant returns because the quality of contractual terms can be an important determinant of the gains that parties are able to realize from trade.¹ This in turn suggests that, from an economic perspective, it is important to understand how contracts are produced. It seems particularly important to examine the production of contracts or individual contractual terms that are widely used – that is to say, “boilerplate.”² In a market-oriented society, boilerplate is the predominant feature of the network of legal obligations that provides the formal structure of economic activity. As a result, the quality of boilerplate can be a crucial determinant of overall patterns of economic activity. Understanding the determinants of the quality of boilerplate is an

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¹ One way in which the quality of a contract determines the value that parties derive from a transaction is by affecting the amount of uncertainty that surrounds the meaning of the parties’ obligations. A good contract will also define the parties’ obligations in the event of various contingencies in ways that mitigate problems posed by asymmetric information. *See generally*, Ronald J. Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984) (demonstrating how the terms of a typical corporate acquisition agreement can increase the total value realized by the parties).

² For the history of standard form contracts, see Nathan Isaacs, *The Standardizing of Contracts*, 27 YALE L.J. 34 (1917); P.S. Atiyah, INTRODUCTION TO THE LAW OF CONTRACT 16 (5th ed. 1995); G.H. Treitel, THE LAW OF CONTRACT 196-260 (1995). For the history of the term “boilerplate,” see Carol Bast, *A Short History of Boilerplate*, 5 SCRIBES J. LEGAL WRITING 155 (1994).

important step towards understanding whether and how the state ought to intervene in its production.

Recent academic literature on this topic has focused on production of boilerplate by either for-profit actors – whether for their own use or for use by their clients – or the state.³ The dominant theme is that for-profit actors typically have sub-optimal incentives to invest in production of contractual terms because they often cannot capture all of the benefits that flow from those investments. As for the state, the main concern is that it lacks the competence to formulate contracts that are suited to the diverse needs of private commercial actors.

This Article takes a different tack and focuses on the role played by entities that are organized as nonprofits (“nonprofits”)—a broad category that includes charitable organizations as well as distinctly non-charitable organizations such as trade associations—in the production of boilerplate. The analysis here begins with and is motivated by the observation that, in the United States at least, nonprofits, and in particular trade associations, seem to play a substantial role in producing boilerplate, at least where the boilerplate is produced for use by some party other than the drafter. As a theoretical

³ See, e.g., Charles J. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CAL. L. REV. 261 (1985); Michael Klausner, *Corporations, Corporate Law, and Networks of Contracts*, 81 VA. L. REV. 757 (1995); Marcel Kahan & Michael Klausner, *Standardization and Innovation in Corporate Contracting (Or “The Economics of Boilerplate”)*, 83 VA. L. REV. 713 (1997); Henry T. Greely, *Contracts As Commodities: The Influence of Secondary Purchasers on the Form of Contracts*, 42 VAND. L. REV. 133, 160-161 (1988). Goetz & Scott and Kahan & Klausner both provide brief discussions of the role of nonprofit organizations in drafting contracts. See, Goetz & Scott, *supra* at 293 and 303-304; Kahan & Klausner, *supra*, at 761-764. Greely is more dismissive. See, Greely, *supra*, at 160-161 (suggesting that few voluntary standard-setting organizations exist for contracts). For an early discussion of (presumably) nonprofit trade associations as a source of commercial norms see K.N. Llewellyn, *Legal Institutions and Economics*, 15 AM. ECON. REV. 665, 672-674 (1925).

matter, there are at least four reasons to believe that it makes a difference whether boilerplate is produced by a non-profit as opposed to a for-profit. The first reason is that, because of their distinctive mandates, when making decisions nonprofits sometimes take into account benefits and costs that are not recognized by for-profit organizations. Second, some nonprofits are relatively well placed to stimulate demand for contracts by credibly assuring prospective users of their value. Third, some nonprofits can produce contracts of a given quality at a relatively low cost because they have superior ability to attract volunteer labor. Fourth, nonprofits can produce contracts at a relatively low cost because they enjoy preferential tax treatment.⁴ The next step in the analysis is to argue that understanding the reasons why nonprofits are so heavily involved in producing contracts constitutes an important step towards understanding whether this state of affairs is likely, from society's perspective, to be optimal. This understanding can inform analyses of whether and when the state ought to play a role in the formulation of contractual terms. It also sheds light on the question of whether state intervention in this area ought to involve encouraging or discouraging the production of boilerplate by nonprofits.

Part II of this Article describes the significant roles that a range of nonprofits play in producing boilerplate in the United States. Part III discusses the reasons why production of boilerplate by nonprofits might be different from production of boilerplate

⁴ The first of these arguments has been discussed but not emphasized in the literature on the production of contracts. See Goetz & Scott, *supra* note 3 at 293, 303; Kahan & Klausner at 762. The second, third and fourth arguments do not appear to have received attention. Analogues to all of these arguments have been presented in the literature concerning the production of goods other than boilerplate. See generally, Henry Hansmann, *THE OWNERSHIP OF ENTERPRISE* 227-245 (1996); Josh Lerner & Jean Tirole, *Some Simple Economics of Open Source*, 50 J. INDUST. ECON. 197 (2002).

by for-profits. Part IV discusses whether it is desirable from society's perspective for non-profits to play a substantial role in producing contracts. Part V discusses the legal implications of the preceding Parts. Part VI concludes.

II. Nonprofits that produce boilerplate

There are a number of different types of sources of boilerplate. Sometimes terms that eventually become boilerplate originate in contracts that are drafted by parties for their own use with little or no assistance from anyone else. On other occasions terms are drafted by for-profit actors —typically legal professionals—for use by other parties. These terms become boilerplate either because they are widely copied or because they are used repeatedly by the drafter or its client. Other examples of boilerplate are drafted from the outset for widespread use and are marketed by for-profit firms as ‘forms’ or ‘model contracts.’ In the past these contracts were distributed in paper form. Now, however, many firms distribute their products in electronic form, and often over the Internet.⁵ Some of the more sophisticated suppliers allow parties to assemble their own contracts either by picking from a range of standard terms or by responding to queries about their preferences.⁶

Although a great deal remains to be written about the production of boilerplate under these circumstances, the focus of this Article is on another situation: the production of boilerplate by nonprofits for use by others. There is no obvious and readily available source of information on the number of occasions on which parties use contractual terms

⁵ See, e.g., LexisOne, at <http://www.lexisone.com>; Westlaw, at <http://west.thomson.com/store/default.asp>; Matthew Bender, at <http://bender.lexisnexis.com/bender/us/catalog?action=home>; Bloomberg, at XXX.

⁶ See, e.g., the products offered by Invisible Hand Software LLC d/b/a Quickform Contracts, at <http://www.quickforms.net> (last visited Aug. 4, 2005).

that have been drafted, in whole or in part, by nonprofits as opposed to other types of organizations. It is however, possible to get a sense of the magnitude of nonprofits' role in the production of boilerplate by examining the range of nonprofit organizations engaged in producing contractual terms intended for widespread use. Most of those nonprofits are trade associations. However, bar associations and a few other types of organizations are also active in this field.

A. Trade associations

In the United States there are several industries in which trade associations are heavily involved in producing contracts. For instance, many trade associations representing various professions involved in the construction industry produce contracts. The best known of these may be the American Institute of Architects (AIA), which has been distributing contracts since 1888. The AIA now offers over 90 distinct contracts and documents. The AIA contracts were originally distributed in paper form. However, like many other organizations the AIA now also licenses its contracts in electronic form. In fact, the AIA contracts are embedded in a sophisticated customized software package that contains a number of potentially useful features. For instance, the software allows information pertaining to a particular project to be inputted only once and then automatically entered where necessary on all of the contracts associated with a given project. The software also permits users to modify the standard terms but still view a record of the deleted material. Users can choose between licenses that allow them to print fixed or unlimited numbers of copies.⁷

⁷ Links to software downloads and information about ordering AIA documents are available at http://www.aia.org/docs_default (last visited Aug. 2, 2005).

An interesting feature of the construction industry in the United States is that there are a number of trade associations offering forms that can serve as substitutes for one another. For instance, in addition to the architects, the Associated General Contractors of America (AGC) offer a range of contracts that is almost as extensive as that of the AIA. Many of the AGC contracts are close substitutes for the AIA contracts and AGC's customized software is similar in terms of the level of sophistication.⁸ In fact, AGC appears to have begun drafting contracts in response to perceived shortcomings in the AIA contracts. Interestingly, by way of comparison, the trade associations involved - in the construction industries in England and Canada have chosen to collaborate to produce a single set of forms.⁹ This kind of collaboration has occurred to a more limited extent in the United States under the auspices of the Engineers Joint Contracts Documents Committee (EJCDC).¹⁰

⁸ The AGC has historically played an important role in the production of the AIA documents. The AIA has traditionally sought the endorsement of its A-Series (construction) documents from several other construction trade associations. Since 1966, however, the AIA has sought only the endorsement of the AGC. Justin Sweet, *The Architectural Profession Responds to Construction Management and Design-Build: The Spotlight on AIA Documents*, 46 L. & CONTEMP. PROBS. 69, 76 (1983).

⁹ In the UK, the Joint Contracts Tribunal (JCT) comprises the Association of Consulting Engineers, British Property Federation, Construction Confederation, Local Government Association, National Specialist Contractors Council, Royal Institute of British Architects, The Royal Institution of Chartered Surveyors, and the Scottish Building Contract Committee. This organization was established in 1931 and produces standard form contracts and other documents for the construction industry.

The Canadian Construction Documents Committee (CCDC) was formed in 1974 and comprises the Association of Consulting Engineers of Canada, Canadian Construction Association, Construction Specifications Canada, and the Royal Architectural Institute of Canada. The CCDC produces more than 20 standard contracts and other documents used in both the private and public sector; approximately 50,000 copies of these documents are sold annually.

¹⁰ EJCDC is a joint venture of the Associated General Contractors of America (AGC), the National Society of Professional Engineers/Professional Engineers in Private Practice (NSPE/PEPP), the American Council of Engineering Companies (ACEC), and the

Besides the construction industry, another industry in which trade associations appear to play a significant role in drafting contracts is real estate brokerage. In the United States, state and local associations of realtors draft various contracts for use in connection with the sale of real estate. Access to the contracts is typically provided to the associations' members as one of the benefits of membership. Many of the contracts are distributed electronically through a software package marketed by a for-profit entity that is a joint venture of the National Association of Realtors and the California Association of Realtors.¹¹

There are other American industries in which trade associations play a prominent role in drafting contracts. For example, trade associations focusing on natural products such as cotton¹² and grain and feed¹³ draft either model contracts or terms designed to be

American Society of Civil Engineers-Construction Institute (ASCE-CI). Links to EJCDC documents are available at

<http://www.agc.org/page.wv?section=EJCDC&name=About+Engineers+Joint+Contract+Documents+Committee> (last visited Aug. 2, 2005).

¹¹ ZipForm, <http://www.zipform.com/company/background.asp> (describing background of the company; last visited Aug. 2, 2005).

¹² The American Cotton Shippers Association and the National Council of Textile Organizations jointly produce the Southern Mill Rules which govern transactions between cotton growers and mills. The rules can be found at http://www.acsa-cotton.org/About_ACSA/Search%20Rules/about_acsa.html. See generally, Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, And Institutions*, 99 MICH. L. REV. 1724, 1726 (2001).

¹³ National Grain and Feed Association, <http://www.ngfa.org>. See generally, Lisa Bernstein, *The Questionable Empirical Basis of Article 2's Incorporation Strategy: A Preliminary Study*, 66 U. CHI. L. REV. 710, 725-30 (1999). Bernstein also discusses trade associations that have drafted model contracts for use in the hay and silk industries. Moving to a different part of the agricultural sector, Cheung mentions in passing a standard contract for beekeepers that was drafted by a trade association. See Steven S. Cheung, *The Fable of the Bees: An Economic Investigation*, 16 J. L. & ECON. 11, 29 (1973). For examples of sample contracts for beekeepers, see the University of Georgia's Honey Bee Program, at <http://www.ent.uga.edu/bees/Pollination/Pollination.htm> (last visited Aug. 2, 2005); Kim Flottum, *Proper Pollination, Using a written contract is good business*, BEE CULTURE, 218-19 (April 1996).

incorporated by reference into other contracts. Another example is the entertainment industry, where associations such as the Director's Guild of America (DGA), the American Federation of TV & Radio Artists (AFTRA), and the Writer's Guild of America (WGA) are active in drafting model contracts.¹⁴ Yet another example is the oil and gas industry, where the American Association of Petroleum Landmen and the American Petroleum Institute draft a number of model contracts.¹⁵ Most associations make their contracts available in electronic form but the degree of sophistication with which they do so varies.¹⁶

There are also a number of international trade associations involved in producing contracts. Perhaps the most prominent example is the International Chamber of Commerce (ICC). In this context the ICC is probably best known for two products: the Uniform Customs and Practice for Documentary Credits (UCP) and Incoterms (short for "International Commercial Terms"). These products are not free-standing contracts but qualify as boilerplate because they consist of terms designed to be incorporated into other contracts, and in particular contracts for international sales of goods. The ICC has traditionally also offered a handful of model contracts for use in connection with international transactions. Recently, it began to offer a service that allows users to draft international sales contracts online. The system prompts the user to enter various

¹⁴ Standard form contracts produced by several entertainment industry unions (including the DGA, AFTRA, and WGA) are available at <http://www.globalproducer.com/PAGES/Lib/CONTRACTS.htm#3> (last visited Aug. 2, 2005).

¹⁵ For a comprehensive global survey of model contracts in the oil and gas industry see, A. Timothy Martin, *Model Contracts: A Survey of the Global Petroleum Industry*, 22 J. ENERGY & NATURAL RESOURCES L. 281 (2004).

¹⁶ An example of an organization that offers printed standard contracts rather than on-line documents is the Rocky Mountain Mineral Law Institute.

categories of information—e.g., price, payment method, description of goods, governing law, etc.—and then produces a contract based on language drafted by the ICC. The contract can be stored online and signed digitally by the counterparty.

Other international associations that draft contracts include: the Association of International Petroleum Negotiators (oil and gas);¹⁷ BIMCO (international shipping);¹⁸ Federation of Oils, Seeds and Fats Associations (oilseeds, oils and fats and groundnuts);¹⁹ the Grain and Feed Trade Association (grain and feed);²⁰ the International Swaps and Derivatives Association (over-the-counter derivatives)²¹; and Lloyd's of London (salvage).²²

Trade associations seem to rely heavily upon volunteers in drafting contracts. Typically they enlist senior members of the industry to serve on drafting committees and then solicit comments on drafts from a broader spectrum of members.²³ Volunteers are typically assisted by one or two paid staff members and, in some cases, outside counsel.

¹⁷ Association of International Petroleum Negotiators, <http://www.aipn.org/modelagreements/> (listing documents for sale; last visited Aug. 2, 2005).

¹⁸ BIMCO, <http://www.bimco.dk/> (last visited August 2, 2005).

¹⁹ Federation of Oils, Seeds and Fats Associations, <http://www.fosfa.org/> (last visited August 2, 2005).

²⁰ Grain and Feed Trade Association, <http://www.gafta.com/> (last visited August 2, 2005).

²¹ International Swaps and Derivatives Association, <http://www.isda.org/> (last visited August 2, 2005). See also, Stephen J. Choi & G. Mitu Gulati, Contract as Statute, 104 MICH. L. REV. __, __ (2006).

²² The 2000 Lloyd's Open Form (LOF) can be downloaded at [https://www.lloydsagency.com/Agency/Agency.nsf/vwAll/856731F0768244CB80256B8F0034E2BD/\\$file/lof%202000.pdf](https://www.lloydsagency.com/Agency/Agency.nsf/vwAll/856731F0768244CB80256B8F0034E2BD/$file/lof%202000.pdf) (last visited August 14, 2005). An alternative standard salvage contract was created by BoatU.S. and is available at <http://www.boatus.com/towing/guide/salvage/contract.asp> (last visited August 15, 2005).

²³ Bernstein, *supra* note 13, at 718 (“In most associations trade rules are drafted and subsequently amended by committees of experienced industry members who serve without compensation”).

It is also worth noting that, in a sense, many trade associations rely upon other trade associations for assistance in drafting contracts as evidenced by cases in which one association consults another association about, and eventually receives an endorsement of, a particular contract. For example, in the construction industry it is quite common for a number of specialized trade associations to endorse general purpose contracts prepared by organizations such as the Associated General Contractors of America or the American Institute of Architects.²⁴

B. Bar associations

The American Bar Association produces a range of model contracts jointly with the American Law Institute. According to the joint venture's website, the best-selling contracts include various types of real estate leases and an asset purchase agreement.²⁵ Unlike many of the trade associations discussed above, the ABA does not seem to have any institutional structures in place to update its contracts. Rather, they seem to be produced on an ad hoc basis on the initiative of specific committees within the organization.

C. Other nonprofits

There are a few miscellaneous types of nonprofits besides trade associations and bar associations that produce contracts. For example, the Rocky Mountain Mineral Law Foundation is an example of a quasi-academic nonprofit that sells a handful of model

²⁴ See, e.g., Minnesota Mechanical Contractors Association, at <http://www.mn-mca.org/index.html> (last visited Aug. 2, 2005).

²⁵ ALI-ABA, <https://d2d.ali-aba.org/index.cfm?fuseAction=displayAllForms&NAVMODE=forms> (listing online courses, article, and forms; last visited Aug. 2, 2005).

contracts for use in the mining and oil and gas industries.²⁶ An intriguing recent development has been the emergence of nonprofits dedicated to drafting and disseminating contracts whose terms reflect commitments to values other than creating purely economic benefits for users. Well known examples of these sorts of organizations are Creative Commons and the Free Software Foundation. These and other organizations freely distribute copyright licenses that are, in their view, consistent with the goal of providing greater access to copyrighted materials than default legal rules would otherwise allow.²⁷ It is not always clear what procedures these nonprofits follow when drafting contracts.²⁸ In addition to providing its own copyright licenses, the Free Software Foundation maintains a webpage analyzing the extent to which various other license agreements are consistent with its commitment to “free software”.²⁹ Similarly, the Open Source Initiative analyzes licenses for consistency with their definition of “open source.”³⁰

²⁶ Rocky Mountain Mineral Law Foundation, <http://www.rmmlf.org> (last visited Aug. 2, 2005).

²⁷ See <http://creativecommons.org/about/history> (“Thus, a single goal unites Creative Commons’ current and future projects: to build a layer of reasonable, flexible copyright in the face of increasingly restrictive default rules”); <http://www.gnu.org/licenses/licenses.html#Intro> (“Published software should be free software”).

²⁸ One commentator has complained, “...[W]hile open source developers pride themselves in the number of eyeballs devoted to fixing buggy software, buggy open source licenses suffer from inattention. To make matters worse, the authors of the most important open source licenses do not regularly evaluate the licenses and fix them when they are broken.” Robert W. Gomulkiewicz, *De-bugging Open Source Software Licensing*, 64 U. PITT. L. REV. 75, 95 (2002). Gomulkiewicz recommends that open source software licenses be drafted by an entity that would periodically consult a wide range of interested parties. This entity would presumably be a nonprofit.

²⁹ See, http://www.fsf.org/licensing/licenses/index_html.

³⁰ See, http://www.opensource.org/docs/certification_mark.php#approval.

Finally, although they do not draft contracts themselves, it is also worth mentioning nonprofits that assist potential users by making contracts drafted by others readily accessible. At least one nonprofit research institution, Contracting and Organizations Research Institute (CORI), has begun to make contracts collected from sources such as filings with the U.S. Securities and Exchange Commission available online without charge.³¹

III. Differences between production of boilerplate by nonprofits and for-profits

There are a number of reasons why it might make a difference whether contracts are drafted by non-profits such as trade associations as opposed to for-profits such as private law firms or established providers of legal information such as LexisNexis or Westlaw. In the first place, nonprofits and for-profits may have different objectives when drafting contracts and so may make different decisions on matters such as how much to invest in drafting or updating contracts, whether to adopt biased terms and what price to charge for the contracts they draft. A second consideration is that the contracts drafted by nonprofits and for-profits may not be equally attractive to potential users. One reason for this is that nonprofits may generally be perceived to be more credible. Alternatively, nonprofits may be perceived to have a higher profile than other producers of boilerplate and so the contracts that they draft will be expected to attract larger numbers of other users, which may in turn make them relatively attractive to each individual user. A third factor is that nonprofits may have lower costs of production because they have superior

³¹ See the database created by CORI (Contracting and Organizations Research Institute), at <http://cori.missouri.edu> (free access to over 40,000 contracts; last visited Aug. 2, 2005).

access to volunteers. Fourth, nonprofits enjoy preferential tax treatment, which may also tend to lower their costs of producing boilerplate.

A. Objectives

Non-profits and for-profits might perceive the benefits and costs of producing boilerplate for use by others differently. In particular, while for-profits might only take into account the net financial returns that they realize from producing contracts,³² non-profits might take into account a broader range of factors when making decisions, factors that a for-profit would regard as ‘externalities.’ It is useful to begin by outlining those factors.

³² The financial benefits need not be limited to amounts received directly from users of contracts. The mere fact that it is difficult to charge users directly for the benefits associated with a good or service does not necessarily mean that a for-profit firm has no incentive to produce that good or service. Goods and services such as the news, television or radio programming, and Internet search engines are all produced by for-profit firms in the face of these constraints. This is typically possible because by distributing these goods from a particular location (virtual or physical) the firm creates a potential audience, access to which it then sells to advertisers. There is no reason why firms producing contracts cannot adopt a similar strategy. In fact, some relatively simple contracts are distributed by for-profit firms on this basis. *See*, for example, the websites of the Internet Legal Research Group, at <http://www.ilrg.com>, and LexisONE, at <http://www.lexisone.com>. In other cases products are distributed below cost in order to demonstrate their quality and thereby promote the long-run business interests of their producer. *See also* Cheung, *supra* note 13, at 29-32 (account of how difficulties of contracting with potential beneficiaries of services were overcome by beekeepers).

³⁴ To see this, imagine a game that involves the drafter choosing whether to offer a high or low value contract and the user subsequently deciding whether to accept the contract when it is offered on a take-it-or-leave-it basis. If neither party can observe the other's actions before acting then the game can be represented as simultaneous-move game with the following payoff structure where c_i represents the cost of drafting each type of contract, p represents the price at which the contract is offered, and v_i represents the value of each type of contract to the user. Suppose we assume that $c_h > c_l$ and $v_h > v_l$ and $v_h > p$. In this case the drafter's dominant strategy is to draft a low value contract. Whether or not the user agrees to pay for the contract depends on whether p is greater than or less than v_l .

1. Externalities associated with drafting contracts

There are a number of factors that a third party drafting a contract for use by others could take into account besides its own (net) financial returns. For one, it might take into account the net benefits that accrue to the customers to whom it sells boilerplate terms. So, for instance, depending upon how much it cares about the welfare of its customers, a drafter with market power may or may not exploit that power by raising the price of contracts that it sells. A drafter's attitude towards its customers will also determine whether it chooses to make unobservable investments in drafting boilerplate or in updating it to reflect new developments. In many situations the profit-maximizing course of action will be to limit investments in drafting and updating.³⁴

It is also worth noting that sometimes drafters' decisions simultaneously affect both their own customers and customers of other firms.³⁵ For example, adopting standardized contractual terms may facilitate anti-competitive collusive pricing by making it relatively easy for the members of a cartel to detect defection from agreed prices.³⁶ Alternatively – and admittedly somewhat contradictorily – failure to adopt standardized terms might harm customers by making it difficult for them to compare prices.³⁷

Leaving aside customers, a drafter also could take into account the benefits or costs its decisions create for third parties, that is to say actors who will not provide compensation to, or demand compensation from, the drafter. These costs and benefits can take several forms. To begin with, if, as is often the case, the drafter deals with only one of the parties to the contract in which the terms are ultimately embodied, the customer

³⁵ See generally, David Gilo & Ariel Porat, *The Hidden Roles of Boilerplate in Standard Form Contracts*, 104 MICH. L. REV. ____ (2006).

³⁶ Douglas G. Baird, *The Boilerplate Puzzle*, 104 MICH. L. REV. ____, ____ (2006)

³⁷ Gilo & Porat, *supra* note 46 at ____.

may pay the drafter to adopt terms that are biased against other parties in ways that are difficult to observe. This represents a cost to the other parties to the contract.

A drafter might also take into account the benefits its actions can generate for third parties. For instance, third parties who have access to copies of the contract (whose prevalence will depend in part upon technological factors)³⁹ might benefit because referring to an existing contract can help them identify contingencies that are likely to arise in the course of certain types of transactions and that ought to be taken into account when planning them.⁴⁰ Starting with an existing contract at hand can also, naturally,

³⁹ The state of technology can influence the ease of both copying and restricting access to contracts. On the one hand, the ability to digitize and then distribute perfect reproductions of contracts to large numbers of users at virtually no marginal cost (for example, by posting it on the Internet) has drastically increased the number of unauthorized copies that are likely to be made of a contract once any unauthorized copying occurs. On the other hand, digitization has also made it easier to limit initial access to contracts by distributing them individually rather than as parts of a package. In the past, the economies of scale associated with distributing contracts in printed form meant that it was cheaper to distribute several contracts as a package than to distribute them separately – hence, the formbook. Now, however, it is feasible to distribute contracts individually in electronic form.

⁴⁰ Kahan & Klausner's empirical analysis of revisions to contracts used in the issuance of corporate bonds suggests that copying in this context is widespread. Kahan & Klausner, *supra* note 3, at 745, 747. But those contracts are, as both a matter of law and of practical necessity, widely distributed and so obtaining access to them is particularly easy.

simplify the task of finding words to express intentions about how various contingencies are to be addressed.⁴¹

A drafter could also take into account the effects of its decisions on third parties who will not necessarily have access to copies of the terms that it drafts, but who either already use, or will use, terms that serve similar purposes.⁴² It is generally the case that each occasion on which a particular contractual term is used increases the likelihood of a dispute over its interpretation being litigated. This implies that each time a person uses a

⁴¹ Kahan & Klausner, *supra* note 3, at 720-721. Claire Hill, *Why Contracts are Written in "Legalese,"* 77 CHI-KENT L. REV. 59, 67 (2001). Copyright law clearly influences the extent to which third parties can benefit from existing contracts in this way. Interestingly, in American cases involving contracts the copyright statute has been interpreted so that assertion of copyright is only likely to prevent the most blatant forms of copying. See generally, Goetz and Scott, *supra* 3, 292 n.78; Paul G. Reiter, Copyright, Under Federal Copyright Laws, of Forms, or Form Books, 8 A.L.R. Fed. 869. The federal copyright statute does protect contracts as "original works of authorship." 17 U.S.C. § 102(a). However, in cases involving contracts the courts have insisted upon more than a minimal amount of originality. See, *Dorsey v. Old Surety Life Ins. Co.*, 98 F.2d 872, (10th Cir. 1938); *Donald v. Zack Meyer's T.V. Sales and Service*, 426 F.2d 1027 (5th Cir. 1970); *M. M. Business Forms Corp. v. Uarco, Inc.*, 472 F.2d 1137 (6th Cir. 1973); *Donald v. Uarco Business Forms*, 478 F.2d 764 (8th Cir. 1973). It has also been held that the specific language of a contract or a business form cannot be copyrighted where the use of that language is essential to expressing a particular underlying idea. *Continental Casualty Co. v. Beardsley*, 253 F.2d 702, 706 (2d Cir.), cert denied, 358 U.S. 816 (1958). Finally, even if specific language is copyrighted, that copyright is not infringed by using similar language embodying the same idea, much less by different language. *Dorsey*, 98 F.2d 872. See also *Aldrich v. Remington Rand, Inc.*, 52 F. Supp. 732 (N.D. Tex. 1942) (tax bookkeeping system); *Crume v. Pacific Mut. Life Ins. Co.*, 55 U.S.P.Q. (BNA) 267 (N.D. Ill. 1942) (reorganization of insurance company), *aff'd*, 140 F.2d 182 (7th Cir. 1944); *Long v. Jordan*, 29 F. Supp. 287 (N.D. Cal. 1939) (pension system). But see *Baldwin Cooke Co. v. Keith Clark, Inc.*, 383 F. Supp. 650 (N.D. Eastern Division Ill. 1974) (distinguishing *Dorsey* on the basis of the sophistication and complexity of format and arrangement of the product involved); *Smith v. Thompson*, 43 F. Supp. 848, 850 (S.D. Cal., Central Division 1941) (distinguishing *Dorsey* because of evidence that the defendant was a former employee of plaintiff and upon leaving such employ immediately set himself up in business and copied in minute details the plaintiff's method of doing business).

⁴² The 'network externalities' described in this paragraph are discussed in more detail in Klausner, *supra*, note 3.

particular contractual term it benefits other users of the same term by increasing the rate at which judicial precedents interpreting and, hopefully, clarifying the meaning of that term can be expected to accumulate.⁴³ In a similar vein, each time a person uses a particular contractual term it creates a benefit for other users of that term by increasing the incentive for actors such as potential counterparties, lawyers and financiers to invest in becoming familiar with the term. The more familiar a term is to these sorts of actors, the more valuable it is likely to be to a user.⁴⁴ Both these points suggest that by producing terms that are or will become a standard a drafter can create benefits for other users of the standard term.

The corollary though is that by selecting a particular term the drafter may impose costs on users of alternative terms. This is because the more widely used is a particular contractual term the less rapidly judicial precedents will accumulate around alternative terms. In addition, the more popular a given term becomes, the weaker the incentive for potential counterparties etc. to familiarize themselves with alternative terms. Both these factors suggest that by producing boilerplate that is or will become a standard a drafter can reduce the value of alternative terms to third parties. If those third parties find it costly to switch to the new terms, for instance because it is costly to read them and analyze their import, then introducing the boilerplate will have served to make the third parties worse off than before.⁴⁵ (The extent to which they are disadvantaged will be the

⁴³ Klausner, *supra*, note 3 at 775-779 and Kahan & Klausner, *supra* note 3, at 722-723.

⁴⁴ Klausner, *supra*, note 3 at 782-786 and Kahan & Klausner, *supra* note 3, at 723-724; Greely, *supra* note 3 at 136-137.

⁴⁵ Empirical studies of corporate and sovereign bond contracts suggest that switching costs in these contexts are high, as evidenced by individual actors' reluctance to adopt novel contracts. See Kahan & Klausner, *supra* note 3, at 751-753; Stephen J. Choi & G. Mitu Gulati, *Innovation in Boilerplate Contracts: An Empirical Examination of*

lesser of the difference between the values of the two sets of terms and the costs of switching to the new terms).

2. Nonprofits' responses to externalities

Are nonprofits more sensitive than for-profits to the externalities associated with drafting contracts? The answer depends on what we are willing to assume about how nonprofits as opposed to for-profits make decisions.

The most straightforward way of approaching this issue is to assume that for-profits always strive to maximize financial returns while nonprofits always faithfully pursue formally stated missions that do not involve maximizing financial returns.⁴⁹ The assumption that for-profits single-mindedly strive to maximize profits implies that they ignore externalities when deciding whether to produce boilerplate. On this view for-profits will only take into account benefits that can be translated into financial returns. Of course, the significance of this point will depend upon the magnitude of the externalities. If an organization has a large share of the market for a given contract then the costs imposed on customers as a result of pricing above cost might be substantial. On the other hand, under these circumstances other externalities might be quite small. The

Sovereign Bonds, 53 EMORY L J 929, 982-89 (2004). For a discussion of the magnitude and importance of switching costs with an emphasis on costs incurred by assignees of contracts see Greely, *supra* note 3 at 136-162 (1988). Choi and Gulati observe that the magnitude of switching costs will depend in part on the importance of speed in preparing the contract. See Choi & Gulati, *supra* at 988 (discussing concern for speed in production of documents used in connection with issuances of sovereign bonds). The introduction of technology that makes it possible to compare documents and highlight differences between them electronically at the touch of a button has almost certainly reduced the costs of switching between closely related contracts.

⁴⁹ This assumption will be relaxed below.

larger is a drafter's share of the market for a given contract, the fewer third parties there will be. This argument holds whether the drafter is one of the principal parties to the contract or an agent such as a law firm.⁵⁰ This factor suggests that if we leave aside the externalities associated with pricing above cost, other externalities are likely to be least significant in industries characterized by high levels of industrial concentration among drafters.⁵¹ Correlatively, these externalities are likely to be most significant in industries characterized by 'atomistic' contracting where no single drafter captures a large share of the social benefits of their efforts.

If we assume that organizations are generally loyal to their missions then nonprofits in general, and trade associations in particular, are likely to respond differently to the presence of potential externalities. One reason for this is that trade associations may find it relatively easy to translate benefits and costs that accrue to their members into financial returns because they may be able to recover the net benefits that accrue to their members by imposing some sort of levy.⁵² This technique is unlikely to be available to a for-profit firm. A second factor is that the missions of trade associations are, typically, to serve the interests of their members and/or their industries.⁵³ This implies that when trade

⁵⁰ Goetz and Scott, *supra* note 3, at 304; Kahan & Klausner, *supra* note 3, at 737-739; Choi & Gulati, *supra* note 21, at 994.

⁵¹ This is consistent with Greely's analysis. See Greely, *supra* note 3, at 158 (suggesting that in the industries he examined barriers to standardization of contracts were overcome by the efforts of participants with large market shares).

⁵² Ronald Coase makes similar arguments about the advantages of having lighthouse services in England and Wales funded by a levy upon shipowners and delivered by a charitable corporation called Trinity House. See Ronald H. Coase, *The Lighthouse in Economics*, 17 J. L. & ECON. 357, 372-374 (1974).

⁵³ See, e.g., "Aligning the Institute for the Millennium," AIA 1999 ("The American Institute of Architects is the voice of the architecture profession dedicated to serving its members, advancing their value and improving the quality of the built environment."); "The Associated General Contractors of America Strategic Plan: 2004-2006" ("The

associations draft boilerplate they will not necessarily be concerned with maximizing their financial returns. So for instance a trade association that takes into account the interests of its members rather than only its narrow pecuniary interests might sell boilerplate at or below its cost of production, even if it could maximize its financial returns by setting a higher price.⁵⁴ Such a trade association may also strive to produce boilerplate that is of high quality, unbiased, widely disseminated, and either similar to terms used by other actors or unlikely to cause those actors to incur undue switching costs.⁵⁵

Of course, on this view, the extent to which a nonprofit takes externalities into account will depend a great deal upon the nature of its mission. For instance, if the membership of a trade association comprises a large and representative portion of the potential users of a particular type of contract, then faithful pursuit of the association's mission should be roughly equivalent to maximization of all of those users' net benefits.⁵⁶ But of course, not all trade associations have large or representative memberships. If the

Associated General Contractors of America, the voice of the construction industry, is an organization of qualified construction contractors and industry related companies dedicated to skill, integrity and responsibility. Operating in partnership with its Chapters, the Association provides a full range of services satisfying the needs and concerns of its members, thereby improving the quality of construction and protecting the public interest.”).

⁵⁴ This argument is an application of Henry Hansmann's more general argument that firms owned by customers might arise where the firm enjoys market power. *See*, Hansmann, *supra* note 4 at 24-25, 150, 158, 169 (1996).

⁵⁵ Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, And Institutions*, 99 MICH. L. REV. 1724, 1741-1743 (2001).

⁵⁶ Goetz & Scott, *supra* note 3, at 303 (“Trade organizations provide a mechanism to internalize at least some of the gains from contractual innovation. If an organization representing a significant subset of the formulation's potential users develops a term, it can supply the coordination necessary to overcome the free-rider problems discussed earlier.”).

members of an association comprise only a small portion of the potential users of a contract then they will not have an incentive to make large investments whose benefits redound principally to non-members.

Similar issues arise where the membership of a trade association is unrepresentative in the sense that the interests of the members systematically diverge from the interests of other users of a contract. An association of manufacturers of consumer goods would be an obvious example of an association whose members' views on contractual terms will not necessarily converge with those of the other parties to the contracts that it drafts.⁵⁷ Similarly, in the construction industry, an association exclusively representing architects may have interests that diverge from those of other potential parties to construction agreements. In these situations the association has an incentive to include unobservable but biased terms in the contracts it drafts. A trade association that is insensitive to the interests of consumers also has an incentive to invest in drafting contracts that facilitate anti-competitive behavior.

Trying to predict how nonprofits and for-profits will respond to externalities becomes even more complicated if we change our behavioral assumptions and take into account the fact that neither for-profit nor nonprofit organizations will necessarily be faithful to their formally defined roles. So, for example, staff attorneys who wish to ensure that they retain their jobs might revise contracts frequently and ignore the switching costs entailed for the organization's members. They might also take the easy route through their days by undertaking purely cosmetic revisions rather than making substantial efforts to

⁵⁷ The divergence of interest here may be more apparent than real since there are a variety of reasons why sellers may find it advantageous to take the interests of their customers into account when drafting contracts. See generally, Clayton P. Gillette, *Rolling Contracts as an Agency Problem*, WISC. L. REV. 679, 690-712 (2004).

develop new terms. Similarly, there may be volunteers who join contract drafting committees solely for the sake of raising their professional profile and contribute little to the process once appointed.

Some might argue that these sorts of agency costs are particularly significant in the nonprofit world because nonprofits have no residual financial claimants. Residual financial claimants such as the shareholders in a for-profit corporation have a strong incentive to hold agents of the organization accountable. This suggests that in nonprofits, agents, including the agents who draft contracts, may have a great deal of latitude to pursue objectives that are inconsistent with the overall missions of their organizations.⁵⁸ On the other hand factors such as the fear of competition (from either for-profits or nonprofits), professional pride or the need to attract continued financial support from members or donors might override the effects of the absence of accountability to residual financial claimants. Other possibilities are that nonprofits will attempt to maximize profits from the sale of contracts because their senior managers personally benefit from higher profits or because they use the profits to subsidize other activities. This last set of factors would cause nonprofits to respond to externalities in exactly the same way as for-profits.⁵⁹

B. Perceptions

1. Ability to offer credible assurances

Regardless of whether nonprofits actually pursue different objectives from for-

⁵⁸ This is not to deny that for-profit firms can be affected by agency costs. See generally, Greely, *supra* note 3, at 165-166 (discussing how agency costs within for-profit firms or between those firms and their lawyers might affect drafting decisions).

⁵⁹ _____.

profits when drafting contracts for use by others, they may be *perceived* to be dedicated to pursuing different objectives. This difference in perceptions may give nonprofits an advantage over for-profits in assuring prospective users of the value of the terms they draft. More specifically, nonprofits that are believed to pursue objectives other than simply maximizing the financial returns associated with drafting contracts might be better placed than for-profits to assure prospective users about the value of the terms they draft or endorse.

The ability to assure prospective users of the value of contractual terms is important because it may be difficult for those prospective users to assess the value on their own. An independent assessment of the value of a contract would involve reading the contract, ascertaining its meaning – taking into account all relevant legal developments – and then considering whether the obligations it sets out are suitable for particular uses. All of these steps require costly investments of time and expertise. Moreover, the value of any given contract can change over time: changes in the law might alter its meaning; the circumstances in which it is being used might change so that new contingencies need to be addressed; or, alternative contracts may be introduced that reduce the overall level of familiarity with the original contract and the number of cases in which it is likely to be interpreted. Prospective users will want to minimize both the costs of assessing value and the risk of adopting a low-value contract.

As we saw in the preceding section, for-profits do not necessarily have incentives to take unobservable actions that increase or maintain the value of the boilerplate that

⁶² This argument is an application of Henry Hansmann's more general argument that firms owned by customers or without any owners at all have an advantage over other types of firms in mitigating problems of asymmetric information. *See* Henry Hansmann,

they produce. Specifically, prospective users of contractual terms drafted by a for-profit organization should be concerned that relatively little effort has been invested in drafting and updating the terms; that it contains terms that are subtly biased in favor of other parties; or, that the for-profit will revise the contract frequently, forcing them either to incur the costs of switching to new terms or to bear the costs associated with using non-standard terms. It may be difficult for for-profits to assuage these concerns.

By contrast, if prospective users believe that nonprofits have an incentive to make unobservable investments in increasing and maintaining the value of contracts that they produce, then nonprofits ought to find it relatively easy to provide credible assurances on all these points.⁶² So, for instance, to the extent that a nonprofit is believed to have an independent incentive to produce high quality boilerplate users may be willing to believe that unobservable investments in drafting and updating have been made. Similarly, concerns about subtly biased terms disappear to the extent that the terms in question have been drafted by an organization that is perceived to be uninterested in taking payoffs from interested parties and that has an independent incentive to draft unbiased terms. Finally, if terms are drafted by a nonprofit that is believed to be sensitive to the costs that its drafting decisions impose upon third parties then users may be confident that the contract will not be revised any more frequently than necessary.

Of course, the practical significance of these potential differences nonprofits and for-profits is unclear. First, for reasons identified above prospective users may perceive

The Role of Nonprofit Enterprise, 89 YALE L. J. 835, 843-845 (1980); Hansmann, *supra* note 54 at 27-29, 230-31, 233-37 (1996).

nonprofits to be no more likely than for-profits to take their interests into account. Here it seems particularly significant that many trade associations do not seem to be representative of the potential users of the contracts that they draft and therefore seem at least as likely as for-profits to inspire concerns about bias. On the other hand, many associations strive to address this potential concern by obtaining endorsements from other trade associations or by participating in drafting coalitions.⁶³

The difference in credibility between nonprofits and for-profits may also be limited because for-profits might use techniques such as warranties and bonds to bolster their credibility. The first of these techniques, a warranty, essentially includes any binding offer to compensate users for harm caused by deficiencies in the contract. An offer of this sort is only effective, however, if it is possible for an adjudicator to verify the quality of the contract. Otherwise the promise of compensation will be unenforceable and the warranty will be of no value to the user. My intuition is that, along most dimensions, the quality of contracts is difficult to verify.⁶⁴ This may be why many producers of standard form contracts seem to disclaim liability for their products.⁶⁵

⁶³ For discussion of analogous practices among standard-setting organizations *see*, Josh Lerner & Jean Tirole, *A Model of Forum-Shopping with Special Reference to Standard Setting Organizations*, National Bureau of Economic Research Working Paper No. 10664; Emmanuel Farhi, Josh Lerner & Jean Tirole, *Certifying New Technologies*, 3 J. EUR. ECON. ASS. 734 (2005)

⁶⁴ This is consistent with Gillian Hadfield's broader claim that the quality of all sorts of legal services is difficult to assess. *See* Gillian K. Hadfield, *The Price of Law: How the Market for Lawyers Distorts the Justice System*, 98 MICH. L. REV. 953 (2000).

⁶⁵ For instance, The Standard Legal Network, LLC sells legal form preparation software and standard form contracts with the following disclaimer:

The documents and services offered for sale through any SLN web site and/or through other authorized distributors are sold with the understanding that SLN is not engaged in rendering legal advice. No document offered for sale, nor any other information contained on the web site or in the software, is intended to constitute legal or other professional advice, and you should not rely solely on the

Another way of assuring users of the value of a contract is for the person seeking to provide the assurances to expose itself to the prospect of a substantial loss if the contract turns out to be of low value. In other words, the person can post a bond to assure the value of its product. This can be accomplished in a few different ways. One way is to establish a reputation that will be sacrificed in the event of widespread dissatisfaction with a product. So for example, clients of a law firm may believe that the risk of one of the firm's contracts being defective is low because the firm has a valuable reputation to protect. Other sorts of bonds can be provided though. For example, one online provider of (free) contracts states: "We're committed to delivering the highest quality forms on the Internet -- so committed, in fact, that we'll pay \$50 to any person who can demonstrate that one of our forms is not compliant with state law."⁶⁶ This reward operates as a type of bond, especially to the extent that it is payable to people other than users who have suffered harm. To the extent that for-profits can use these sorts of bonds to provide credible assurances of the value of contracts they should not be at a disadvantage to nonprofits.

services and/or documents in this software, nor any other information contained on the site, for making legal decisions. You should consult with an attorney for specific advice tailored to your situation.
See, <http://standardlegal.net/terms.html>. *See also* the similar disclaimers issued by U.S. Legal Forms, Inc., *At* <http://www.uslegalforms.com/disclaimer.htm>., LawDepotTM.com, *at* <http://www.lawdepot.com/terms.php>, and The Consus Group, *at* http://www.consusgroup.com/about_us/legal_terms_use.asp.

⁶⁶ Internet Legal Research Group. *See also* LawDepotTM.com *at* <http://www.lawdepot.com/contracts/serviceagree/preview.php> (offering \$100 to the first person to find a mistake in form contract). (Since this reward is only offered to the first person to find a mistake it is more difficult to characterize as a bond.)

2. Ability to attract other users

There may be another significant type of difference between perceptions of nonprofits and for-profits that produce boilerplate. It is possible that nonprofit trade associations generally have a higher profile than for-profits. This raises the possibility that the contracts produced by nonprofits will be expected to attract relatively large numbers of users. We have already seen that the value of a contractual term is influenced by the rate at which it is expected to be clarified through litigation and the likelihood that other actors in the marketplace will be familiar with it.⁶⁷ This in turn implies that the value of any given example of boilerplate sometimes depends upon how many other people are expected to use it in the near future. Therefore, all other things being equal, boilerplate that is expected attract large numbers of users, whether because it stands out amidst a crowd of alternative terms or because its drafter is not expected to introduce alternative terms, will tend to be more valuable.

One might speculate that nonprofits, or at least trade associations, will generally have a higher profile than for-profits. If this is the case potential users will tend to gravitate toward boilerplate produced by nonprofits simply because they expect other users to do so. However, the claim that nonprofits have a higher profile than, for example, prestigious law firms or well established providers of legal information is dubious. Moreover, even if nonprofits have a relatively high profile, for-profit organizations have an offsetting advantage. Specifically, for-profits may be better placed to make credible commitments to refrain from introducing alternatives to an existing set of contractual terms. Since for-profit firms often ‘use’ contracts as principals or as paid drafters, their

⁶⁷ *Infra*, section III.A.1.

profits depend upon being intimately familiar with the contracts that they use. As a result their switching costs may be higher than those of a nonprofit that is simply distributing a contract. Therefore, for-profit firms' commitments to use particular contractual terms may be more credible. As a result, it is far from clear whether nonprofits or for-profits have an advantage in convincing potential users that their terms are likely to be popular.⁶⁸

C. Production costs

Nonprofits may also differ from for-profits in the sense that they face different costs of production. One reason this might be the case is because nonprofits may have superior access to volunteer labor.⁶⁹ However, there may be factors that offset this advantage.

1. Access to volunteers

Having the option of tapping volunteers to assist in drafting contracts might be quite advantageous. One reason is that, as discussed in the previous subsection, it is difficult to assess how well a contract has been drafted. This is true not only for potential users of contracts but also for organizations that employ agents to draft contracts. Under these

⁶⁸ For suggestions that either trade associations or law firms might be able to mitigate coordination problems, see Goetz & Scott, *supra* note 3, at 293; Kahan & Klausner, *supra* note 3, at 762-763 ("In this context standard-setting would mean the development of model contract terms, which firms could adopt at their option . . . standard setting institutions can potentially respond to the coordination problem.").

⁶⁹ The term volunteers is used broadly here to refer to any individual or organization that provides goods or services on terms that are more favorable than fair market value. Sometimes it may be difficult to determine whether an individual or the organization with which they are affiliated is the true source of a donation. See, for example, The National Association of Venture Capitalists, http://www.nvca.org/model_documents/working_group.html (listing individuals who assisted in drafting model contracts according to the law firm or venture capital firm with which they are affiliated).

circumstances agents have an incentive to shirk their responsibilities. Naturally, external incentive mechanisms such as bonuses, warranties and bonds (reputational or otherwise) can mitigate this problem. To the extent that these fail, however, it will be helpful if internal factors such as altruism, professional pride or the desire to exercise and improve skills motivate agents to exert themselves. This will frequently be the case for volunteers.

A second reason why access to volunteers might be important in drafting contracts is because it may be useful to have large numbers of people assist, at least in small ways, in the drafting process. The principal reason for this is that an extraordinarily large number of combinations of contingencies can arise in the course of the performance of even a moderately complex contract. It is very difficult for any single person, or even small group of people, to foresee all of the contingencies and accurately analyze whether the contract will be interpreted to provide appropriate guidance in each scenario. However, a large group of readers may be well suited to undertake this analysis collectively, even if each member of the group only devotes a relatively small amount of time to the task. The reason is that if the group is sufficiently diverse each member will bring different experiences to the table and will identify and focus on different sets of contingencies.⁷⁰ In addition, allowing readers to play a role in selecting the problems upon which they focus may be a useful way to harness the private information that they possess about their own capabilities. Providing monetary compensation to members of such a large group might be prohibitively costly, because of both the transaction costs of processing payments and

⁷⁰ This insight is summed up in Eric Raymond's aphorism, "Given enough eyeballs, all bugs are shallow." Eric Steven Raymond, *The Cathedral and the Bazaar, version 3.0*, at <http://www.catb.org/~esr/writings/cathedral-bazaar/cathedral-bazaar/ar01s04.html> (last visited Aug. 2, 2005).

the difficulty of assigning a price to each contribution. If, however, the members of the group provide their services on a voluntary basis then this sort of collective enterprise becomes a viable mode of production. In fact it may be superior to production by a smaller group whose members provide their services in exchange for monetary compensation. This is the logic that has been offered to explain the success of open source software projects and other instances of what Yochai Benkler calls peer production.⁷¹

Of course, it is quite possible that access to volunteers does not provide a significant advantage in the production of boilerplate. In the first place, the usefulness of volunteers is likely to depend upon how skilled they are; when it comes to drafting contracts unskilled volunteers may well hinder the process more than they help. Furthermore, it may be possible to replicate the advantages of relying on volunteers by going out of one's way to hire highly motivated employees and, where appropriate, asking large numbers of them to contribute at least small amounts of time to each drafting project. A for-profit organization such as a law firm can easily adopt these practices.

Do non-profits have better access to volunteers? One would expect the answer to depend in part on the reasons why people do and do not volunteer. One reason for volunteering is altruism – the desire to benefit others. Some altruists may be interested in benefiting the users of a particular class of contracts, e.g. 'the members of the grain and feed industry', or 'users of computer software'. However, if altruists volunteer on behalf of a for-profit organization that supplies contracts to these users, some of the benefits of their efforts are likely to flow to the owners of the organization. Not many altruists are

⁷¹ Yochai Benkler, *Coase's Penguin, or, Linux and The Nature of the Firm*, 112 YALE L. J. 369 (2002).

likely to be interested in helping this particular class of beneficiaries. This suggests that most altruists will be more willing to volunteer to draft contracts on behalf of nonprofits than for-profits.

Whether or not nonprofits have superior access to volunteers also depends on the reasons why people choose *not* to volunteer for certain organizations. Leaving aside altruism, many people volunteer in order to socialize or to exercise and hone their professional skills or to obtain status in the eyes of their peers. There is no obvious reason why these sorts of benefits cannot be obtained by volunteering to draft contracts on behalf of a for-profit enterprise. However, for some people the direct personal benefits they could receive from volunteering on behalf of a for-profit organization might be outweighed by an aversion to gratuitously conferring benefits on the owners of a for-profit organization.⁷² This aversion might lead even people who are not exactly altruistic to prefer to volunteer for non-profits. It is unclear, however, how prevalent this attitude is. In fields such as software development and the publication of academic journals people frequently volunteer to benefit for-profit organizations.⁷³ For-profit firms also are frequently able to induce their customers to provide volunteer labor in forms that range from responses to customer satisfaction surveys to voluntary transfers of significant technological innovations.⁷⁴

⁷² The existence of such an aversion seems particularly plausible when the for-profit organization is a competitor. So for instance, law firms might donate their services to a trade association but not to another private law firm.

⁷³ Benkler, *supra* note 71, at 440-441 (discussing whether possibility of others benefiting discourages voluntary participation in information production).

⁷⁴ For discussion of more extreme examples *see*, Dietmar Harhoff, Joachim Henkel & Eric von Hippel, *Profiting From Voluntary Information Spillovers: How Users Benefit by Freely Revealing Their Innovations*, 32 RES. POLICY 1753 (2002) (discussing when and why users voluntarily reveal innovations to suppliers).

2. Other potential differences in production costs

There are other factors that might systematically influence the relative costs of producing contracts in nonprofit as opposed to for-profit organizations. Some of these might offset the effects of having superior access to volunteer labor.

One factor is that nonprofits might systematically be run more poorly than for-profits. The reasoning behind this claim has already been discussed: It may be that the absence of residual financial claimants reduces the overall level of accountability within nonprofit organizations and thus makes them inefficient producers of contracts, or for that matter, anything else. But the counter-arguments listed above are also applicable here. Specifically, competitive pressures, efforts to select agents who take pride in their work, or accountability to senior managers, members or donors, might, either singly or in combination, be effective substitutes for monitoring on the part of residual claimants.

Another factor to consider is that in certain cases either nonprofits or for-profits might have privileged access to resources used to produce or distribute contracts. For instance, trade associations have privileged access to their members. This may give them an advantage both in contacting members for feedback and in distributing contracts. Alternatively, for-profit legal information services firms might have better access to the technology used to distribute contracts electronically. However, it is far from obvious that these factors are economically significant since firms in one sector can typically obtain access to resources held by firms in another sector through contract.⁷⁵ For

⁷⁵ An important counter-example to this general claim might be ISO, a for-profit organization that produces standard form contracts that are widely used by property and casualty insurers. ISO seems to benefit from the fact that it controls valuable actuarial data that is required to price the terms of any given policy. See, generally, <http://www.iso.com>.

example, a for-profit organization can purchase access to a trade association's membership list. Similarly, a nonprofit organization can contract with a for-profit software developer to develop technology for distributing contracts electronically.

D. Tax treatment

Nonprofits also differ from for-profits that draft boilerplate for use by others in terms of their tax treatment. Nonprofits are exempt from certain state and local taxes, most notably franchise and property taxes.⁷⁶ These exemptions clearly give nonprofits a competitive advantage over for-profits by lowering their relative costs of production.

Many types of nonprofits, including trade associations, also derive an advantage from being exempt from federal income tax.⁷⁷ Income from exempt nonprofits' unrelated business activities is subject to a federal tax called the unrelated business income tax (UBIT).⁷⁸ (In this context an unrelated business activity is one that is unrelated to the purposes that form the basis of the nonprofit's exemption.)⁷⁹ However, for many nonprofits, selling or licensing contracts seems unlikely to qualify as an unrelated

⁷⁶ The details vary from state to state. *See generally*, FRANCES R. HILL & BARBARA L. KIRSCHTEN, *FEDERAL AND STATE TAXATION OF EXEMPT ORGANIZATIONS* ¶14.04 (1994).

⁷⁷ Internal Revenue Code, 26 USC § 501(c) (listing exempt organizations). § 501(c) (6) refers to “[B]usiness leagues, chambers of commerce, real-estate boards, boards of trade, or professional football leagues (whether or not administering a pension fund for football players), not organized for profit and no part of the net earnings of which inures to the benefit of any private shareholder or individual.” The revenue from the sale of these types of materials to the members of a trade association is likely to be subject to the unrelated business income tax.

⁷⁸ Internal Revenue Code, 26 USC §511(a).

⁷⁹ Internal Revenue Code, 26 USC §513(a). (“The term “unrelated trade or business” means, in the case of any organization subject to the tax imposed by section [511](#), any trade or business the conduct of which is not substantially related (aside from the need of such organization for income or funds or the use it makes of the profits derived) to the exercise or performance by such organization of its charitable, educational, or other purpose or function constituting the basis for its exemption under section [501](#) . . .”).

business activity.⁸⁰ Moreover, if the contracts are licensed in exchange for royalties the royalties are excluded from the definition of unrelated business income.⁸¹

Exemption from income tax gives nonprofits an advantage over for-profits by reducing the nonprofits' cost of raising capital to fund their operations.⁸² Consider the following example. Suppose that an organization needs to raise \$10,000 to finance the production of a set of contracts for sale to other parties. Assume that the normal after-tax rate of return on an investment in a venture such as this would be 10 percent and that the tax rate is 30%. If the organization is a for-profit it will have to provide an investor with an after-tax return of \$1,000, meaning that it will have to earn roughly \$1428.57 in before-tax income. Suppose, however, that the organization is a tax-exempt nonprofit. In this case it might try to finance the business by charging its members dues in return for an implicit promise to provide goods or services at below-market prices in the future. In a sense therefore, the members can be characterized as 'investors.' Assume that, like other investors they demand a return of 10 per cent on their investment. Notice that the nonprofit will only have to earn \$1000 in before-tax income to generate this return. This means that the nonprofit will be able to charge a lower price for its products than a for-

⁸⁰ In the case of a trade association any revenue derived from the distribution of material to its members that assists them in the conduct of their business seems to be clearly related to the purposes of the association. *See* 26 C.F.R. § 1.513-1 Definition of unrelated trade or business (especially Example 6: "Z is an association exempt under section 501(c)(6), formed to advance the interests of a particular profession and drawing its membership from the members of that profession. Z publishes a monthly journal containing articles and other editorial material which contribute importantly to the accomplishment of purposes for which exemption is granted the organization. Income from the sale of subscriptions to members and others in accordance with the organization's exempt purposes, therefore, does not constitute gross income from unrelated trade or business.").

⁸¹ Internal Revenue Code, 26 USC §512(a), (b)(2).

⁸² *See* Henry B. Hansmann, *Unfair Competition and the Unrelated Business Income Tax*, 75 VA. L. REV. 605, 609-612 (1989).

profit while still generating an acceptable return for its investors. Alternatively, it can charge the same price for its products and generate a relatively high return for its investors, thus encouraging them to invest. The narrower is the range of sources of exempt income, the more significant will be the tax-based incentive to produce boilerplate that generates exempt income.⁸³

IV. Welfare implications

Many of the differences between nonprofits and for-profits that engage in the production of boilerplate for use by others should, if anything, serve to give nonprofits a competitive advantage. This conjecture is consistent with the fact that if we leave aside boilerplate produced by firms for their own use, nonprofit trade associations appear to dominate the production of many types of boilerplate. It is also worth noting that some of the distinctive features of production of boilerplate by nonprofits, and in particular their potentially greater sensitivity to externalities and access to volunteers, might make it relatively attractive for users to obtain boilerplate externally from a nonprofit rather than producing it internally.

Even if nonprofits enjoy competitive advantages over for-profits in the production of boilerplate that does not necessarily mean that it is in society's best interests for nonprofits to exploit those advantages. Whether or not it is socially optimal for nonprofits to

⁸³ The consequences would be similar if nonprofits were not exempt from income taxation but typically were able to avoid generating taxable income by offsetting income from business activities with expenses incurred in providing benefits to members. However, Internal Revenue Code 26 USC § 277 limits the scope for this practice. That provision prevents certain non-tax-exempt organizations from treating expenditures on member benefits as deductions from income generated from business activities.

dominate the production of boilerplate depends, among other things, on the reasons why they dominate.

For instance, if nonprofits dominate for-profits because of differences in their objectives the desirability of this state of affairs depends upon which type of organization's objectives are best aligned with society's interests. If we assume that the principal difference between the two types of organizations along this dimension is that nonprofits are more likely to take into account externalities, and so are more likely to make socially optimal drafting decisions, then having nonprofits dominate the production of boilerplate seems benign. However, as we have already seen, there are reasons to question the assumption that nonprofits are more likely to take into account externalities.⁸⁴ Not all nonprofits are even ostensibly interested in advancing the interests of a large and representative portion of the users of the contractual terms that they draft. In the case of some of these nonprofits, deciding whether or not their missions are consistent with the interests of society is a value-laden exercise – who is to say whether it is in society's best interests for software to be free? Moreover, even those nonprofits whose mission statements are undisputedly benign may have agents who routinely deviate from those missions. Still other nonprofits may have objectives indistinguishable from for-profits because they treat the production of boilerplate as a means of generating revenue to support other activities.

The social welfare analysis seems more straightforward if nonprofits' advantage over for-profits rests on superior access to volunteers. If there are certain people who prefer, for whatever reason, to volunteer on behalf of nonprofits rather than for-profits, then

⁸⁴ For similar arguments see Clayton Gillette, *Harmony and Stasis in Trade Usages for International Sales*, 39 VA. J. INT'L L. 707, 737-38 (1999).

allowing nonprofits to use those volunteers enhances social welfare to the extent that it improves the welfare of the volunteers. Society also benefits from a certain amount of additional production to the extent that if barred from volunteering for a nonprofit some people would choose to engage in less productive activities.⁸⁵

The welfare analysis is slightly more complicated if nonprofits' advantage over for-profits lies in superior ability to offer credible assurances of the value of contracts. Allowing nonprofits to dominate for-profits for this reason seems desirable if users of contracts accurately assess nonprofits' credibility. In this case, having nonprofits produce boilerplate minimizes the costs to society of distributing boilerplate by minimizing the costs to users of searching for appropriate boilerplate. It is a different story, however, if users regularly err in their assessments of nonprofits' credibility. For example, it may be the case that an undeserved aura of credibility surrounds trade associations that draft boilerplate, even though they are in fact no more credible than other organizations. In this case society would be better off if boilerplate were produced by the organizations that were actually, rather than merely perceived to be, the most credible.

Finally, in the absence of offsetting considerations, it seems undesirable to allow nonprofits to derive any significant advantage over for-profits from their preferential tax treatment. Differential tax treatment of this sort tends to allow relatively inefficient nonprofits to offer contracts at lower cost than more efficient for-profits. This will cause

⁸⁵ See also, Kevin E. Davis, *The Regulation of Social Enterprise*, in BETWEEN STATE AND MARKET: ESSAYS ON CHARITIES LAW AND POLICY IN CANADA, J. Phillips, B. Chapman, and D. Stevens eds. (2001) at 485, 496.

society to expend more resources than necessary in producing contracts of a given quality.

In light of the above, it is difficult to say as a general matter whether it is socially optimal for nonprofits to dominate the production of boilerplate. At this point, all we can say is that there are certain conditions under which this might be an optimal state of affairs. First, in producing boilerplate nonprofits might take into account a larger proportion of the benefits to consumers and third parties than would a similarly situated for-profit. Second, nonprofits might be accurately perceived to be more credible than for-profits. Third, nonprofits might have greater access to skilled volunteer labor. Under any or all of these conditions it seems reasonable to presume that having nonprofits play a significant role in the production of boilerplate is socially desirable.

It would, of course, be nice to have direct empirical tests of whether society benefits from having nonprofits as opposed to for-profits produce boilerplate. But it is important to recognize that testing hypotheses about whether the behavior of a particular set of drafters is socially optimal is difficult. The principal difficulty stems from the need to make judgments about whether any given drafting decision is or is not socially optimal.⁸⁶ For example, in their seminal article Goetz and Scott seem to suggest that trade associations in the construction industry were too slow to draft novel contracts in response to a change in construction practices in the 1970's. They report that the leading trade associations, the American Institute of Architects and the Associated General Contractors, took nearly ten years to produce new contracts. Goetz and Scott imply that

⁸⁶ Kahan & Klausner, *supra* note 3, at 750 (“We have no choice but to rely on our own judgment in arguing that a particular formulation of the event risk covenant is suboptimal . . .”).

this delay was sub-optimal.⁸⁷ However, they reject with virtually no explanation the possibility that it was optimal for the trade associations to wait and gather more information about the new practices before drafting a new contract.⁸⁸ In principle though, the costs associated with a faster response, in the form of either being stuck with a less than optimal contract or having to switch to a revised version, might well have outweighed the benefits of introducing a new contract.

V. Legal implications

Understanding the conditions under which boilerplate is likely to be produced in a manner consistent with society's interests can have the practical benefit of informing the design of legal norms. In particular, understanding the manner in which contracts are produced can help to inform decisions about whether and how the state should become involved in the formulation of contractual terms.

A. Should the state intervene in the production of contracts?

One of the main implications of the discussion to this point is that in deciding whether state intervention in the production of contracts is required it is important to consider the abilities of both for-profit and nonprofit organizations. There is room for disagreement about how well the state—or any given branch of it—is likely to fare if it attempts to intervene in the production of contracts. However, it seems reasonable to presume that the lower is the quality of the contracts that non-state actors are capable of

⁸⁷ Goetz & Scott, *supra* note 3, at 304.

⁸⁸ *Id.* at 297-298 (arguing the construction industry deliberately chose “to keep the concepts loosely defined to permit a flexible response to the perplexing changes in the economic climate”, quoting Walter F. Pratt, Jr., *Afterword: Contracts and Uncertainty*, 46 LAW & CONTEMP. PROBS. 169, 170-71 (1983)).

producing the stronger is the case for state intervention. Most of the academic literature on this topic has focused on for-profit actors and the extent to which factors such as externalities and asymmetric information limit their ability to produce contracts. This narrow focus is potentially misleading. For example, it may be reasonable to conclude that the quality of contracts generated by for-profit actors will be relatively low in industries where none of the users of the contract, or their agents, has a large share of the market. However, it would not be reasonable to conclude that the quality of contracts in these types of industries will typically be low. This is because in many industries where atomistic contracting prevails there is at least one trade association that invests in drafting standard form contracts. There may also be other nonprofits, such as a local bar association, that do the same. For any or all of the reasons set out in Part III these nonprofits might make very different drafting decisions from for-profit organizations.

For example, in some regions a paradigmatic example of an industry characterized by atomistic contracting is the real estate brokerage industry—particularly in regions where lawyers play a limited role in real estate closings. In many areas state or local realtors’ associations draft standard form contracts.⁸⁹ All of the factors identified in Part III might, at least potentially, induce these associations to invest in producing high quality contracts. First, in relation to most terms of contracts such as agreements of purchase and sale the association’s interests should be well-aligned with those of the entire body of users, especially when its members are just as likely to be involved on one side of the transaction as the other. (Listing agreements, in which brokers’ interests are

⁸⁹ See, for example, the range of jurisdictions that produce contracts for use with Zipforms, the software package produced by a joint venture by the National Association Realtors and the California Association of Realtors. See, <http://www.zipform.com/order/order.asp>.

consistently opposed to those of non-members (property owners) are, therefore, potentially problematic.) Second, the association is well placed to assure users that due care has been taken to update the contracts to reflect changes in the law: Ultimately the lawyers drafting the contract are accountable to users in their capacities as members of the realtor's association. Third, the association can tap volunteers from its membership to participate in reviewing existing contracts and proposed revisions.⁹⁰ Fourth, these associations typically benefit from preferential tax treatment. As a result, if they engage in tax-exempt activities such as the production of standard form contracts they should be able to offer members a relatively high return on the membership dues 'invested' in the association.

The more general point here is that without knowing anything about the nonprofits active in an industry it is pointless to speculate about the quality of the contracts available to participants in that industry. This idea clearly has implications for how contract law ought to vary across industries. It also has implications for how contract law ought to vary across societies as it suggests that the nature and quality of a society's associational life will be an important determinant of the quality of the contracts formed by the members of that society.

B. How should the state intervene in the production of contracts?

Suppose we assume that it is necessary for the state to intervene in the drafting of a particular class of contracts. In this case the idea that nonprofits can play an important

⁹⁰ In an interview with the author the general counsel of the California Association of Realtors described a lengthy review and consultation process surrounding new contracts. The principal participants in the process were volunteers, aided by two staff lawyers. Interview with June Barlow, Vice President and General Counsel California Association of Realtors, July 18, 2005.

role in drafting contracts has implications for the manner in which the state should intervene. Specifically, it implies that in addition to or instead of attempting to draft contracts itself, the state might attempt to encourage nonprofits to emerge and participate in the process.⁹¹ The encouragement offered could take many forms, ranging from legal doctrines that presume the validity of terms formulated by nonprofits,⁹² to privileged access to government officials, to preferential tax treatment.

Consider, for example, a jurisdiction in which the quality of residential agreements of purchase and sale is perceived to be poor, perhaps on account of the atomistic structure of the real estate brokerage industry and the absence of any related trade association. A government agency could respond to this situation by drafting a set of terms to be implied by law into every agreement of purchase and sale. Alternatively though, the agency might attempt to encourage a group of real estate brokers, or perhaps a group of legal professionals, to form an association with a mandate to draft and maintain a model contract. The arguments set out in Parts III and IV suggest reasons why, if structured appropriately, such an association might do a better job than a set of for-profit actors drafting contracts independently.

A similar observation applies where a nonprofit is involved in drafting contracts but is doing a poor job. There are a number of circumstances in which this might be true: The nonprofit's membership may not be representative of the users of the contract; it may be using the income from the sale of contracts purely to fund its other activities and thus

⁹¹ For similar suggestions see Greely, *supra* note 3, at 169 (suggesting that standards-setting organizations be promoted); Ronald J. Mann, "Contracting" for Credit, 104 MICH. L. REV. __, __ (2006) (recommending that standardized credit card agreements be drafted by intermediaries such as Visa or Mastercard).

⁹² For a recommendation along these lines see, Choi & Gulati, *supra* note 21 at __.

have no particular incentive to make unobservable investments in quality; it may make little use of volunteer labor; or, it may not be tax-exempt. Under these conditions there may be grounds for state intervention. But that intervention need not involve direct production of contractual terms by the state. It could also involve encouraging other nonprofits to enter the industry. For example, a court might threaten to undertake heightened scrutiny of any standard form contract drafted by the association unless endorsements have been obtained from associations representing all potential users.⁹³

VI. Conclusion

The irony here is that some of the most iconic products of a market-oriented society, contracts, often seem to be produced in a realm that is ordinarily presumed to be at least one step removed from a free market. Moreover, this may not be a bad thing, even according to conventional economic criteria. This has potentially significant implications for our understandings of the determinants of the quality of contractual terms, whether and how the state should intervene in the formulation of those terms, and, more generally, the role of trade associations and other nonprofits in a market economy. These topics all warrant further investigation.

⁹³ For a recommendation that a similar strategy be adopted in Europe see Hugh Collins, *The Freedom to Circulate Documents: Regulating Contracts in Europe*, 10 EUR. L. J. 787 (2004).