Sticky Contracts (or Why Don't Law Firms Have R&D Departments?)

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In markets with sophisticated players, theory goes, the response to a court decision that erroneously changes the meaning of a term should be immediate. New contracts should clarify the meaning of the clause in question so that there is no risk that the court's erroneous interpretation will apply in the future. Reality, many have observed, is often different, particularly when it comes to boilerplate or standard-form terms. Standard contract clauses often remain unchanged and without clarification, even though a court decision either created or flagged uncertainty regarding the meaning of those clauses. Numerous theories for contract stickiness have been posited. But the academic understanding of the stickiness phenomenon sits at the point of post hoc rationalizations understandable in light of the difficulty of empirically testing for the factors that produce Testing for the factors that determine change is relatively a lack of change. straightforward; one looks to theory for factors that might cause change and then examines the data to see which of possible causal factors moved in line with the change. But with non-change, it is less clear how one might empirically test the theoretical conjectures; nothing changes, meaning no correlations to observe.

We attempt to get the problem by examining the views of the actors responsible for the non change. That is, we ask lawyers and their clients why they were unable to move quickly to reform their contracts in response to a problematic court decision court. Understanding what lawyers say are the barriers to responding quickly to a court decision potentially gives us a window into what factors they consider important.

This study takes a recent incident of contractual stickiness in the sovereign debt market—a court decision that was widely agreed to have been problematic, but in response to which few contracts were revised—and asks market participants why they think the stickiness occurred. The reasons that the market actors give for the stickiness are then compared to the academic theories and to the empirical data. For example, if a majority of market actors say that they did not alter their contract clauses because of the view that courts would penalize them for doing so, that explanation can be examined (Does the case law suggest that a court would really penalize them for making a change?). Or if the explanation from market actors is that they cannot change because the market would impose a price penalty for a change, that can be examined (Is it empirically the case that clauses that altered suffer a price penalty?). While one cannot directly study the factors causing non-change, there are insights to be gained into the stickiness phenomenon by cataloging the possible explanations and eliminating those that are inconsistent with the empirics.