

Instituto OMG – II International Conference On Legal
Strategy, Santo Domingo, 2019

CONTRACTS AND CONTRACT LAW: BEHAVIORAL INSIGHTS

Eyal Zamir

Hebrew University of Jerusalem

Economic Rationality

- **Cognitive rationality** – people's preferences conform with basic requirements, such as completeness, transitivity, and dominance. People take all available information into account, disregard irrelevant information, etc.
- **Motivational rationality** – people seek to maximize their own utility (firms seek to maximize their profits), regardless of the position of other people, moral norms, etc.

Normative Economics

- **Consequentialist** – Only outcomes ultimately determine the morality of anything.
- **Welfarist** – only the welfare of human beings ultimately counts.
- **Preference-based** – human welfare is determined by the extent to which people's desires are fulfilled.

Judgment and Decision-Making

Daniel Kahneman & Amos Tversky



Heuristics and biases (e.g., availability – determining the likelihood of an event according to how easy it is to remember similar events).

Typology of Contracts

- **Commercial** – Firms contracting as part of their commercial activity.
- **Private** – Individuals contracting outside of their professional activity.
- **Consumer** – Firms contracting as part of their commercial activity, with individuals who purchase goods and services for their personal, family, or household needs.

Pre-contractual Negotiations

- **Availability**
- **Over-optimism**
- **Reactive Devaluation**
- **Elimination by Aspect**

Pre-contractual Negotiations: Default Rules and other Reference-points

- **Legal default rules (*ius dispositivum*);**
- **Trade usages;**
- **Previous transactions between the parties;**
- **and more.**

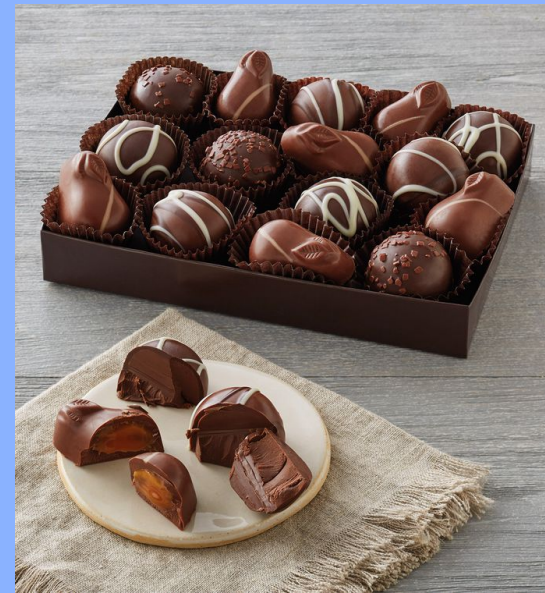
Pre-contractual Negotiations: Default Rules and other Reference-points

- Standard economic analysis – saving on **transaction costs** (and sharing information).
- Behavioral insight: default rules both **follow** common expectations and **shape** them.

Pre-contractual Negotiations: Default Rules and other Reference-points

- **Stickiness** of default rules
- **Omission Bias** – When a choice involves both benefits and costs, prospects and risks, people often prefer to avoid making any active decision; thus sticking to the status quo.
- **Endowment effect** – people place a higher value on things that they already have, than on things they have to acquire.

Pre-contractual Negotiations: Default Rules and other Reference-points



Pre-contractual Negotiations: Default Rules and other Reference-points

The Default	Choice of the Comprehensive Policy	Willingness to pay more for Comprehensive Policy
Comprehensive Insurance Coverage	53%	32%
Limited Insurance Coverage	23%	8%

Framing Liquidated Damages

Contract	Completion Date	Price	Liquidated Damages	Bonuses
A	X	P	\$1000 for each day of delay	None
B	X + 100	P - \$100,000	\$1000 for each day of delay	\$1000 for each day of earlier completion, up to 100 days

Supplier-Customer Relationships: Odd Pricing

Kenneth Manning and David Sprott (2009)

Condition	Lesser Pen	Better Pen	Choice of Lesser Pen
A	\$2. ⁰⁰	\$2. ⁹⁹	56%
B	\$1. ⁹⁹	\$3. ⁰⁰	82%
C	\$1. ⁹⁹	\$2. ⁹⁹	70%
D	\$2. ⁰⁰	\$3. ⁰⁰	69%

Supplier-Customer Relationships: Odd Pricing



Supplier-Customer Relationships: Framing Product Characteristics

“75% lean beef” versus “25% fat beef” (Levine et al. (1985, 1988))

Choice Task	Cheaper Car	More Expensive Car	Saving per 100 Kilometers
A	12 KPL	8 KPL	4.167 (12.5 – 8.33)
B	40 KPL	20 KPL	2.5 (5 – 2.5)

Supplier-Customer Relationships: Framing of Prices as Discounts or Surcharges



Price Framing: What is “Regular Price”?

Dominican Republic Flight + Hotel Packages



XXXX Hotel

5.0 out of 5.0

Fri, Aug 30 - Wed, Sep 4

Logan Intl. - Las Americas Intl.

Regular price

\$2,568

The price now is **\$1,381** per person

Save \$1,187!

Supplier-Customer Relationships: Miscellaneous

- Short **Deadlines** for Promotion Sales and Short Renewal Cycles
- **Gifts** versus Price Reductions
- **Deferred and Contingent Payments**
- Lenient **Return Policies**

Market Solutions?



Thank You!