THE LEGAL INSTITUTIONAL ENVIRONMENT IN BRAZIL AND THE COLLECTIVE AND PRIVATE GUARANTEE MECHANISMS FOR ECONOMIC TRANSACTIONS

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Abstract
A country’s formal institutional environment influences the degree of uncertainty in contractual relations, as it defines the frameworks for production, exchange, and distribution through its legal, political, and social rules, affecting the forms of governance in risk management. Many existing studies on Transaction Cost Economics are based on institutional environments consisting of legal traditions guided by Common Law, quite distinct from Brazil’s Civil Law system. As a systematic and critical analysis, this study examines the relationship between the Brazilian legal institutional environment and the adoption of mechanisms of coordination by Brazilian companies to guarantee and improve their transactions’ efficiency in order to derive a conceptual model relating the legal system’s impacts on transactions’ costs and governance structure and the adoption of mechanisms of coordination. The analysis indicates that Brazilian legal institutions lack efficient mechanisms to support economic transactions due to an unstable contractual law basis and an ineffective judicial system, which generates high transaction costs and stimulates the use of collective and private mechanisms of coordination to minimize risks arising from the institutional environment.

Key words: Institutional Environment; Transaction Cost Economics; Contract Law; Coordination; Guarantee of the Transaction.
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1. INTRODUCTION

The institutional environment, consisting of the set of legal, political, and social rules that ground economic processes, defines the rules of the game of production, exchange, and distribution with regard to economic transactions. Thus, changes in political institutions, property rights, contract law, norms, and customs influence the reconfiguration of economic organization (North, 1990; Williamson, 2000).

From this perspective, it can be understood that institutional environment factors influence the degree of uncertainty of the context in which its agents function, enhancing or reducing uncertainty, and, consequently, affecting the related forms of governance because of variation in transaction costs in risk management.

Focused on a specific aspect of the legal institutional environment, namely, contract law (considering the importance of contracts in the economy of organizations), Williamson’s studies (1979, 1991) related different visions of contract law to different types of governance structures from the perspective of Transaction Cost Economics (TCE). According to this author, different concepts of contract law provide crucial supports for each form of governance (market, hierarchy, and hybrid forms), defining them (Williamson, 1991). Williamson's proposal seems to be consistent, in that it assumes influence of the legal institutional environment on transaction costs, with focus on the economy of contracts.

Contracts have received increasing attention in the economy, especially among the neo-institutionalist economists. In his collection of articles focusing on contracts in the New Institutional Economics (NIE), Ménard (2004) mentions two different approaches on the importance of contracts: (i) with regard to economic theory, their function is to coordinate and guarantee economic activities in a context where social norms and personal relationships are insufficient in assuring the fulfillment of obligations; and (ii) with regard to the NIE, the concept of contracts is directly related to the concept of transactions, varying in form according to the different arrangements under which they are implemented.

Neoclassical economic theory was grounded in the naive view that agents exchange perfect information for a transaction behaving in good faith, and contracts were considered optimal arrangements of production or consumption that can be designed efficiently and negotiated at zero cost (Zylbersztajn & Sztajn, 2005). The NIE, in turn, criticizes the neoclassical view as being devoid of realistic attributes, and takes into account that agents seek their own interests and behave astutely, often disclosing information incompletely or distortedly. Under certain circumstances, agents may act in an opportunistic way, generating costs to the parties in designing the necessary safeguards against the risks of this opportunism that increase transaction costs (Williamson, 1975, 1985).

However, given the fact that the rationality of the parties is limited in uncertain environments, and that to predict and safeguard against risks of all possible contingencies is virtually impossible, agents choose modes of governance that reduce transactional problems at a lower cost. The logic is simple: a market governance structure that allows agents to transact with reduced risks of bounded rationality and tendencies of opportunism is preferable to hybrid forms or hierarchy as a form of governance. If, however, the market and the hybrid forms do not resolve transactional problems, the hierarchical governance structures are preferable (Barney & Hesterly, 2004).
Despite it denotes such relevance, studies related to this subject have shown a lack of contextualization with regard to the Brazilian legal institutional environment, or more specifically, with Brazilian contract law, since the contributions of the literature on contracts from the perspective of TCE are largely derived from authors of Anglo-Saxon countries, whose legal tradition is distinct from that in Brazil (Azevedo, 2005). In reality, there are peculiarities of Brazilian contract law requiring consideration in such analysis of the relationship between the legal institutional environment and theory of transaction costs.

Noting that Brazilian legal institutions lack effective mechanisms to support transactions due to an unstable contract law basis associated with an ineffective judicial system, previous studies (Caleman & Zylbersztajn, 2012; Almeida & Zylbersztajn, 2012; Rocha & Bataglia, 2015) point out that companies in Brazil tend to adopt alternative and complementary mechanisms within contracts, either collectively or privately, as a way to coordinate and guarantee the transaction, minimizing the risks of this uncertain institutional environment.

Therefore, in the form of a critical and systematic analysis, this paper seeks to examine the following question: from the point of view of its contract law, how is the Brazilian institutional environment related to the adoption of collective or private coordination mechanisms aimed at guaranteeing the economic transactions?

Thus, the purpose of this study is to analyze the relationship between the Brazilian legal institutional environment with regard to contracts and the arrangements of governance and coordination practiced by companies in Brazil to guarantee transactions and improve efficiency.

The remainder of this paper consists of four sections. In the next section, the legal institutional environment and the treatment given by TCE to contracts are explored. In the third and fourth sections, an approach to contract law is presented as the guarantee mechanism of the transaction, specifically analyzing Brazilian contract law and its impact on TCE and alternative coordination mechanisms adopted collectively or privately by companies to compensate for the insecurities generated by an unstable institutional environment. Finally, the relevance of the approach is justified and its contributions are noted, opening the possibility for future research.

2. THE LEGAL INSTITUTIONAL ENVIRONMENT AND CONTRACTS IN TCE

According to Douglass North (1991), institutions consist of the set of constraints built to structure social, political, and economic interactions. These are the “rules of the game,” and they can be formal (such as laws, constitutions, property rights, contract law, etc.) or informal (such as norms of behavior, conventions, codes of conduct, customs, etc.), created by individuals in order to regulate their relationships in a stable way.

Although he includes informal institutional elements, North emphasizes that the fundamental rules of the game are embodied in the constitutions and laws, by which politic agents are governed and the property rights structure is outlined, defining the rules of competition and cooperation in the markets in several nations. Thus, the personal ties, social norms and sanctions, and reputational factors are relevant institutional arrangements, but not sufficient to assign enforcement and security to the contracts (Nee, 2005).

Through the prism of NIE, the institutional environment can be defined as a set of political, social, and legal norms establishing the basis for the production, transaction, and distribution of products, and whose parameters define the different governance structures. The institutional environment defines the limits of organizations and these, in turn, also affect the
environment. Changes in the institutional environment, then, cause changes in governance and transaction costs (Williamson, 1991).

**Figure 1 – Institutions**

<table>
<thead>
<tr>
<th>Level</th>
<th>Purpose</th>
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<tbody>
<tr>
<td>Level 1 (Social theory)</td>
<td>Often noncalculative, spontaneous.</td>
</tr>
<tr>
<td>Level 2 (Legal system)</td>
<td>Get the institutional environment right</td>
</tr>
<tr>
<td>Level 3 (ICE – contractual arrangements)</td>
<td>Get the governance structure right</td>
</tr>
<tr>
<td>Level 4 (Neoclassical economics)</td>
<td>Get the marginal conditions right</td>
</tr>
</tbody>
</table>

Source: Adapted by the authors from Williamson (2000, p. 597)

Attempting to classify institutions into different levels, Williamson (2000) groups at a more basic level (Level 1) the primitive institutions, whose constraints of conduct are imposed by traditions and customs, associated with sociology, and at a more superior level (Level 2), the constitutions and laws, setting the legal system. At Level 3 are governance institutions, that is, the governance infrastructure represented by contractual arrangements that reflect the laws, whose central issue is the enforcement of the contracts, and at the last level (Level 4) is the scope of the allocation of resources, associated with the neoclassical economics (Figure 1). Levels 1 and 2 form the institutional environment. It is important to note that "changes in the institutional environment work as balance shifters and can induce alternative forms of governance" (Zylbersztajn, 1995, p. 46).

The legal system is considered a tool for the organization of life in society. In this context, Acemoglu and Johnson (2005) distinguish the so-called property rights institutions, whose purpose is to protect individuals against the expropriation of government and the
power of elites, from the contracting institutions, which are meant to facilitate and assure private contracts. Indeed, studies based on this approach have asserted that the regime of contract law impacts investment and forms of organization of firms. Williamson (1991) mentions that clauses based on the doctrine of excuse\(^1\), for example, can raise the transaction costs in hybrid forms of governance, because the parties would be reluctant to carry out specific joint investments given the risks involved. In franchise situations, if contractual law favors free franchisor discretion over the franchisee as a quasi-vertical relationship, it would increase the transaction costs of this hybrid model.

When it comes to contract law, it is important to consider that the viability of investments is associated with the capacity of the State to ensure the enforcement of the contractual rights and obligations. Moreover, the possibility to apply alternative mechanisms of dispute resolution is also relevant. The perspective of NIE on contracts highlights that the contract is designed according to the coercive capacity of the courts and private mechanisms of protection for the agents, who strategically choose the most appropriate contractual arrangement in terms of incentives and more effective ways of dispute resolution (Zylbersztajn & Sztajn, 2005).

Contract law is understood as the set of laws and norms governing contracts. Enzo Roppo (2009) defines contract law as a set of historically changing rules and principles that performs a dual function: on one hand, it designs the contract according to the economic operations effectively practiced; on the other hand, it molds these economic operations in accordance with certain interests. This is a more modern view of contracts linking the concept to its economic relevance. Heretofore, the law considered contracts singly, in a strictly legal field, as purely legal institutions. However, the recent doctrinal position has recognized and stated that the underlying foundation of contracts is their economic function, defining them as economic fact. In this regard, several economic functions of contracts are mentioned: the promotion and circulation of wealth, collaboration, risk prevention, dispute prevention or resolution, lending, and provision of guarantees, among others (Gomes, 2008). Such contractual economic function is considered determinant for its legal protection, justifying the existence and importance of contract law. Hence, a prevailing position assumes that contracts governing interests without economic or social utility do not even deserve legal protection (Gomes, 2008).

To facilitate an understanding of the relationship between contract law, transaction costs, and forms of governance, a brief examination of how contracts are treated in TCE should be made. After a long time of neglect, the importance of contracts in the economy was considered in Ronald Coase's work, which introduced the vision of transactions as mechanisms backed by contracts. In his seminal work dealing on the nature of the firm, Coase (1937) defines the firm as a nexus of contracts whose coordination reflects the limitations imposed by the institutional environment. The different ways of accomplishing such coordination, via form of governance, along with different institutional environments, result in different outcomes for organizations (Zylbersztajn & Sztajn, 2005).

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\(^1\) According to the excuse doctrine, the contractual obligation of a party can be excused without the need to compensate for damage to the other party, when unpredictable events make the fulfillment of the obligation impractical, impossible, or frustrate the purpose of the contract. *Force majeure clauses*. Retrieved November 17, 2014, from <http://www.jus.uio.no/pace/force_majeure_clauses_drafting_advice_for_the_cisg_practitioner.jennifer_m_bun d/_6.html>.
Azevedo (2005) provides an explanation of the recent incorporation of contracts into economic thought. Neoclassical economic theory was based on the assumptions of the unlimited cognitive ability of the agents and the disclosure of complete information necessary for economic interactions without costs, reducing the relevance of the contracts as a safeguard instrument. From the 1960s, however, the idea of transaction costs associated with the assumption that information can be asymmetrical and may cause adverse selection (non-performing of desirable economic relations or performing of undesirable practice) and moral hazard (disagreement with the agreed conditions) imposed the need to rethink traditional neoclassical economic theory, through the incorporation of the notion that hiring is a costly activity that can impact the economic performance of firms (Azevedo, 2005), thus opening the way to the foundations of TCE.

Zylbersztajn and Sztajn (2005) summarize the primary contractual theories in economy, outlining the assumptions of Neoclassical Theory, Theory of Economic Analysis of Law, Agency Theory, and the NIE (Table 1). As already mentioned, according to Neoclassical Theory, contracts represent optimal arrangements of production or consumption in an environment of perfect information and benign attitudes of the agents, and they can be designed efficiently and negotiated at zero cost by the parties. Therefore, it does not consider the existence of contractual disputes, and price incentives and exchange gains are sufficient for the transactions between the parties. This view is criticized as being unrealistic. Another unrealistic view on the contracts is presented in the Economic Analysis of Law, according to which the law and its application by the courts are able to define the optimal contract. The focus lies in the role of the courts, as providers of efficient solutions and guarantors of the fulfillment of contractual promises, in being able to resolve post-contractual disputes at no cost. The Agency Theory, in turn, takes into account that the information exchanged between the parties are asymmetrical and that there is moral hazard in transactions. Thus, it is recognized that there are unobservable phenomena that affect the decisions of the agents and, consequently, the impossibility to design optimal contracts. It assumes that there is a conflict of objectives between the principal and the agent and, with greater focus on costs ex ante, seeks an optimal contractual design that takes the agent to allocate efforts desired by the principal in the production, transferring risk and sharing results efficiently.

Finally, based on the assumptions of opportunistic behavior and bounded rationality, the NEI assumes that agents strategically choose contractual arrangements on the basis of efficiency, preferring arrangements that offer more efficient incentives and dispute resolution mechanisms. The contract design relies on legal rules, the court’s coercive capacity, and the emergence of private mechanisms of guarantee for the agents. TCE breaks the myth of the omniscient hyper-rationality of homo economicus, assuming that agents cannot predict all possible derivations in an economic relationship or formulate contractual answers before unforeseen eventualities (Barney & Hesterly, 2004). In Simon's words (1947, p. 24), the agents are “intendedly rational, but only limitedly so.”

Williamson (1985) defines opportunistic behavior as intentional action by which agents pursue their own interests in the transactions and act for their own benefit, taking advantage of contractual gaps or omissions to the detriment of the other party. In other words, it is characterized by "the strategic manipulation of information or misrepresentation of intentions" (Williamson, 1975, p. 26), and involves lying, stealing, cheating, and calculated efforts to mislead, distort, disguise, obfuscate, or otherwise confuse partners in a transaction (Williamson, 1985). Such behavioral assumptions generate costs to the agent in distinguishing the propensity of his partners to behave opportunistically. If there were no opportunistic
behavior, all economic transactions could be made on a simple promises basis. However, because of problematic opportunism and inevitable bounded rationality, agents need preparation and caution to protect themselves from potential damages, resulting in additional costs for the transaction (Barney & Hesterly, 2004).

### Table 1 – Contractual Theories in Economics

<table>
<thead>
<tr>
<th>Theory</th>
<th>Assumptions</th>
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<tbody>
<tr>
<td>Neoclassical Theory</td>
<td>Contracts are devoid of reality attributes. They represent optimal arrangements of production or consumption in an environment of perfect information and benign attitudes of agents. Contracts can be designed efficiently and negotiated at zero cost.</td>
</tr>
<tr>
<td>Theory of Economic Analysis of Law</td>
<td>The law and its application improve the efficiency and the welfare of the agents. The courts define the ideal contract or their application at no cost. The focus is on the courts as guarantors of the fulfillment of the promises, as being able to solve post-contractual disputes at no cost.</td>
</tr>
<tr>
<td>Agency Theory</td>
<td>Information is asymmetric and with moral hazard. There are conflicting objectives between the principal and the agent. The main focus is on <em>ex ante</em> costs. It is sought as an optimal contract design that takes the agent to allocate efforts desired by the principal in the production, transferring risk and sharing results efficiently.</td>
</tr>
<tr>
<td>New Institutional Economics (NIE)</td>
<td>The focus is <em>ex post</em> costs resulting from opportunism and measurement problems. The contract will be designed according to the legal rules, the courts coercive capacity, and emergence of private mechanisms of protection for agents. Agents strategically choose the contractual arrangement with incentives and more efficient dispute resolution mechanisms.</td>
</tr>
</tbody>
</table>

**Fonte: Elaborated by the authors, based on Zylbersztajn e Sztajn (2005).**

Addressing this issue, Rachel Sztajn (2010: 5-6) brings clear definition of what would be the transaction costs, going beyond mere financial costs and comprehending all effort, attention, and time of the agents around the risks involved before, during, and after the transaction. Macher and Richman (2008) summarize the sources of transaction costs, with focus on uncertainty and bounded rationality, based on three authors: (i) according to Simon, individuals are limited in their ability to plan the future and predict contingencies; (ii) according to Hart, although contractual planning be possible, the parties have difficulties in developing a common language to describe actions and situations, especially for issues in which they have little previous experience; and (iii) according to Lewis and Sappington, although it is assumed that the parties can plan and fully negotiate a contract, the difficulty in communicating their plans to a third non-informed party (e.g. the courts) remains, and it is also difficult for this third party to reasonably enforce the fulfillment or verify the exact claims of the disputing parties. Thus, in this context, all contracts are necessarily incomplete and uncertain.
Complete contracts would be capable of specifying all the attributes of a transaction, such as date, location, price, and quantity, dispensing with the need for additional verification of rights and obligations of the parties during the execution of the contract, as this would outline all possible future events (Cateb & Gallo, 2007). In this sense, the concept of a complete contract suggests that the agents have perfect cognition, able to anticipate, identify, and establish optimal answers for all possible contingencies involved in the transaction, in what Williamson (1979) refers to as the phenomenon of *presenciation*. In other words, the parties should be able to agree in the present on all possible events that could affect the contract, so that there is no ambiguity or gap for posterior questioning. Not only that, the parties should have ample cognition allowing them to verify whether all conditions of the contact are being fulfilled by the other party, regardless of any incentives for renegotiation (Milgrom & Roberts, 1992). However, assuming that the information is not symmetrical (which can be intentional), the rationality of the agents is not unbounded, and that the environment is full of uncertainty, the image of a complete contract is questioned and demystified.

Whereas firms are the nexus of contracts, firm and market types are governance alternatives, and the choice between them is made primarily based on transaction costs (Coase, 1937). TCE focuses on contractual relationships to stimulate more efficient *ex ante* investments and more efficient execution *ex post* (Joskow, 2005) in reducing transactional costs. In this context, it becomes relevant to consider the contract law to which contractual relations are subject because the interactions of economic agents are subject to the institutions and are governed by them (North, 1991), especially the legal institutions.

3. THE CONTRACT LAW AS GUARANTEE OF TRANSACTION

The fundamental role of institutions is to reduce environmental uncertainty in defining a stable structure of human interaction (North, 1991). In this context, contract law, as a level of legal institution, appears as the set of rules that guides and disciplines contractual relations, with the ultimate aim of facilitating the exchange between agents (Williamson, 1979) and ensuring economic transactions (Figure 2).

**Figure 2 – Contract Law and Economic Transactions**
The approach and correlation between contract law and the foundations of TCE were initially proposed by Williamson in 1979 in his article *Transaction-Cost Economics: The Governance of Contractual Relations*, which was later adjusted in 1991, with *Comparative Economic Organization: The Analysis of Discrete Structural Alternatives*. The essence of both papers is the same, except for a few modifications in evidence of further progress on the subject. In these works, Williamson says that each of the forms of governance would find support in different conceptions of contract law, considering three classifications adopted by American jurist Ian R. Macneil, namely: classic contract law, neoclassical contract law, and relational contracts (Williamson, 1979).

**Classical contract law**, characterized by its emphasis on formal documents, strict compliance with the terms of the contract, and striving to anticipate every possible contingency (what he calls *presenciación*), as well as on self-enforcement, would be adjusted with the *market governance*, in which impersonal buyers and sellers make their exchanges in no specific transactions. In this case, the main aspects of the relationship governed by the contracts are considered sufficient against the risks, and the lack of mutual dependence makes seeking alternatives in the market possible, which ultimately protects the parties against opportunism.

**Neoclassical contract law**, which recognizes a more complex world and the incompleteness of contracts, focuses on the mechanisms that enable the continuity of contractual relations through a reliable system of alternative dispute resolution, such as arbitration. Williamson related this conception of contract law to what he initially called *trilateral governance*, referring to specific investment transactions with some degree of dependency between the parties. In this sense, the continuity of the relationship rather than its breakup would be more interesting to the parties, resorting to the assistance of third parties in disputes. In the second study, a relation is established with the so-called *hybrid forms*. Here, Williamson also refers to *relational contracts*, which emphasize the relationship as a whole, not limited to the instrument signed between the parties. The contract is considered a complex transaction being developed over time, by increasing mutual dependence, specific investments, and trust between the parties. For this reason, according to Williamson, this contract model would be associated with highly idiosyncratic transactions that require very specific assets.

Finally, Williamson introduced a specific doctrine called *forbearance*, relating this exclusively to internal organization (*hierarchy*). He justifies this correlation with the fact that specialized human and physical assets for specific use disfavors the possibility of transferring them to other uses, enabling a form of organization with superior adaptive properties, such as internal organization.

However, despite the importance of Williamson's work in correlating the TCE to contract law, it must be noted that these conceptions concern the common law system, whose legal tradition differs from the Brazilian legal system, which is based on civil law\(^2\). Brazilian

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\(^2\) The common law system is adopted by countries of Anglo-Saxon origin (e.g., England, USA, Canada, Australia, Ireland etc.), whose main characteristic is represented by an unwritten law based on judicial precedents (previous court decisions in similar cases). There is no significant codification of rules of law or statutes. Judicial precedents are maintained over time in records, or documented historically in collections, to guide new cases decisions. Thus, the sentences are based on uses and customs, and similar cases are usually judged according to the same orientation. The civil law system, in turn, is essentially encoded. Countries with
contract law has particularities regarding the historical background and current treatment that require more contextualized attention.

While it is customary to assign to Roman law the origin and basis of several concepts related to contracts, the contract as it is considered today in the Brazilian legal system results from significant evolution that began with the rise of capitalism, and had its essential designs outlined from the ideals defended by the French Revolution. Brazilian contract law imported fundamental notions of free will and autonomy, and freedom of contract, especially from the French Code, also called the Napoleonic Code. This was the first major modern codification, widespread, which mirrored the political, ideological, and economic achievements of the bourgeoisie in the Revolution of 1789. According to Venosa (2013):

As a repulse to the privileges of the old ruling class, this Code brings the acquisition of private property to the culmination of the person's right. The contract is subservient to the acquisition of property and, by itself, sufficient for this acquisition. In the French system historically justified, the contract is a mere instrument to reach the property. The individual, contrary to the old regime, then could have full autonomy to enter into a contract and full possibility to be owner. The contract is placed as a means of circulation of wealth before possible only to a privileged class (p. 380).

Thus, initially, the classic notion of Brazilian contract law was based on the following dogmas: (1) the opposition between the individual and the State as a necessary evil that must be reduced; (2) the autonomous will of individuals as an essential element in the organization of the State and contractual relations; (3) the principle of economic freedom; and (4) the formal conception of freedom and equality that is provided and guaranteed by law (Fiuza, 2007). In accordance with this overestimated conception of autonomy of will and freedom of contract, the parties would freely set contractual contents according to their interests, supported by the foundations of capitalism. Their wills as expressed in the contract would be considered sufficiently fair to the parties, who are formally free and equal. The State would act with minimal intervention, merely as the guarantor of this will and contractual freedom.

Later, with the advent of the Industrial Revolution and the advance of capitalism, there was the transformation of the Liberal State to the Welfare State, which resulted in the modification of the concept of contracts. The assumption that the mere equality provided by law would ensure equilibrium between the contractors, ignoring their social conditions, was understood as unrealistic. Some contractual relations, such as labor and collective contracts (i.e., consumer contracts), among others, showed the existence of inequality between the parties.

this legal tradition have continually updated legal codes dealing with the subjects claimable in court and the procedures and sanctions to be adopted. Judges may be guided by previous decisions, but, with a few exceptions, they have certain freedom to interpret the codified law and apply it to each case. The rules are strictly coded, but admit several interpretations, under the aegis of certain guiding principles.

3 It is possible to clearly see that the outlines of this classic conception of contract law in the civil law system stem from claims of the French Revolution. Roppo (2009, p. 35) explains that the bourgeois revolutions and liberal societies born from them abolished the privileges and legal discrimination of systems in many semi-feudal regimes of the former regime, claiming equality of all citizens before the law. This logic also assigns the importance of the codification of law in this legal system as a mechanism of certainty and limitation of State power over the individual freedoms.
parties and consequent dissatisfaction of large sectors of the population due to the imbalance, leading to demand for State intervention in economic life (Gomes, 2008). At that time, the law acknowledged the existence of categories of individuals who were weaker economically or socially, who could not be treated as equals under certain contractual situations. The State began to intervene in contractual relationships to legally compensate for the weakness of the contractual position of some contractors, through the technique of unequal treatment for unequal individuals. The State began to control the economy, dictate standards, and impose determined contractual contents, prohibiting some types of clauses in contractual relations (Gomes, 2008). Gustavo Tepedino comments (2003) that:

Civil law - as well as the other branches of so-called private law, commercial law and labor law – suffers a deep intervention by the State. It tried to successfully prevent that the exasperation of individualistic ideology continued to intensify inequality, with the formation of new pockets of miserable - rather distant prospect than imagined by liberal ideology in the previous century, that is, the wealth of nations from the wealth of bourgeoisie - impeding even the market regime, essential to the capitalism. We're talking, as everyone knows, about the consolidation of the Welfare State (p. 117).

This situation came to clash with the principles of autonomy of will and freedom of contract contemplated by the classic Brazilian view of contract law, colliding with the dogma of liberalism. From this evolution comes the contemporary format of contract law as is found currently in the Brazilian legal system. Basically, contemporary law lives with the existence of a permanent dialectic between liberal and social conceptions (Venosa, 2013). In other words, autonomy of will and the contractual freedom of the agents remain valid, though limited by the principles safeguarding social interests that are imposed by law and the State.

The Welfare State, which marks contemporary Brazilian contract law (Tepedino, 2003), had a primary result of State intervention in contractual relations, imposing the application of social principles such as the Social Function of the Contract\(^4\). There are two forms of State intervention in contracts based on the argument of social function: the justification of public order and the acts of contractual dirigisme (Pereira, 2012).

The rules of public order are of mandatory application aimed directly and primarily to protect the best interests of the community, prevailing, therefore, over private interests (Costa, 2000). They aim to discipline and protect the fundamental interests of society and the State, establishing fundamental legal bases of the economic order (Amaral Neto, 1999). In this sense, individual will is exercisable in the manner and within the limits that the legal system provides, according to the public order. The law commands or prohibits certain behaviors, so that when one executes a contract, one cannot escape from the observance of these standards.

\(^4\) Article 421 of the Brazilian Civil Code provides that "the freedom of contract will be exercised by reason and within the limits of the social function." Social function of the contract represents a principle of modern contract law according to which contracts, even when their final purpose is to satisfy individual interests of the parties, cannot affect social interests, prevailing this latter in case of conflict. Based on this principle, prejudicial contracts are annulled, the cancellation of the contract by excessive burden is admitted, clauses that unreasonably injure third parties are invalidated or certain types of contract are prohibited (Pereira, 2012). The same idea is present in the property rights (social function of property), in labor relations (social function of firms), etc.
So, if on one hand, the contract reflects the will of the parties, on the other, it is subjected to the public order, as a result of a "parallelogram of forces" (Pereira, 2012).

By contractual dirigisme, State intervention becomes stronger in the economy of contracts. The State sometimes acts by containing its effects and at other times by changing them, in the interest of social justice. Such acts of dirigisme occur through the establishment of coercive clauses, defining certain rights and obligations of contractors (e.g. employment contracts) or attributing the authority to the courts to review the contract, allowing the State to replace the will of the parties (Pereira, 2012).

A contract law marked by State interventionism brings important implications for the economy of contracts and hence, organizations. For example, consideration of the rules of labor law governing labor relations in Brazil, whose peculiarities well reflect the intervention of a Welfare State, allows for reflection on issues related to hierarchy (internal organization), not only in terms of high financial costs related to labor and social security charges, but also in terms of the costs associated with monitoring and inspection, such as compliance with work safety standards, management of union relations, and legal uncertainty due to the position of labor courts with strong inclinations in favor of employees, among other things. Thus, contractual interventionism could result in high costs of vertical integration, favoring other forms of governance. In a very similar sense, Williamson (1991) states that the intervention of the judiciary in the internal disputes of the companies could also increase the cost of the hierarchy, encouraging hybrid governance forms instead.

Another important implication arising from contemporary Brazilian contract law is related to the vagueness of the concept of public order and social interest. Pereira (2012) points out the problem:

[These concepts] occupy one and other areas of floating delimitation, that jurists hardly can define. According to generally accepted doctrine, public order rules are those that guide the minimum bases of economic organization; the fundamental principles of labor law. Finally, the rules that the legislator erect in basic canons of the social, political and economic structure of the nation. (...) Considering that the concepts of public order and good manners vary, and jointly the content of their standards in consequence, it will be correct to state that all the time the contract is the moment to balance these two forces, reducing the field of contractual freedom to the extent that the legislator deems appropriate to broaden the scope of public order, and vice versa (p. 22-23).

5 The so-called Theory of Unpredictability (Teoria da Imprevisão) is a consequence of this contractual dirigisme. Regulated by the Civil Code in its Article 478, this theory is based on the principle of economic balance of the contract emanating from social function, and allows a party to breach his contractual obligation if extraordinary events, unforeseen and unpredictable, deeply modify the objective conditions between contractors. This measure is very similar to the excuse doctrine of the common law system, as mentioned earlier, addressed by Williamson (1991). Under the same reasoning, Williamson claims that provisions of this nature can raise transaction costs in hybrid forms, for example, because the parties would be reluctant to carry out specific investments together, given the uncertain conditions of the transaction. The wording of the Article is as follows: “Art. 478. In contracts of continuous or deferred execution, if the obligation of one of the parties becomes excessively onerous, with great advantage to the other, due to extraordinary and unforeseen circumstances, the debtor may claim the termination of the contract.” (http://www.planalto.gov.br/ccivil_03/LEIS/2002/L10406.htm).
Such inaccuracy and variability of social and legal concepts of public order that characterize contemporary Brazilian contract law added to the intervention of the State in the relationships, bringing about another significant implication for the economy of contracts: the increase of the uncertainty of the institutional environment and the consequent insecurity in investments. The logic is that if agents are inserted into an environment where the State, based on a general principle of social function or public order whose definitions are unclear, has the power to intervene in private contractual relations, they do not feel comfortable to perform certain contracts or investments.

To illustrate, it is worth mentioning the study of Rezende and Zylbersztajn (2012), which aimed to exploit the instability created by contradictory judicial decisions relating to contractual breaches in agribusiness transactions. The authors verified that chambers of same court, in that case, the Court of the State of Goiás, had pronounced different decisions in similar cases, revealing a very insecure legal institutional environment. The disputes were related to soybean contracts broken by farmers due to the increase in soy prices. While some chambers favored the buyers, ruling for the forced continuity of the contract between the parties, others ruled in favor of the farmers, according to the argument of social function and economic balance.

The authors note how the agribusiness system was affected by second order effects, as a result of this uncertain context; there were more stringent collateral demands from lenders, more difficulty in negotiation with buyers, a lower quantity of forward contracts, among other factors, which also started to harm the farmers who did not break the contracts. This demonstrates how the formal institutional profile influences and modifies the relations of economic agents (North, 1990).

Such insecurity is also portrayed by Almeida and Zylbersztajn (2012) in a study that dealt with the rural credit market in Brazil. Their research revealed that agents engage all efforts to not resort to the courts to solve disputes arising from rural credit contracts; the major reason is the uncertainty generated by the judiciary to the creditor on the outcome of the lawsuits, since the debtor can obtain a favorable decision, depending on the interpretation of the judge. According to these authors, three immediate effects result from such legal uncertainty for credit transaction: a) the agents restrict the offer or transfer their risk to the interest rate to be charged; b) requirement of the quantity and quality of collateral is raised in order to inhibit the opportunism of the borrower; and c) there is a strong practice of other mechanisms such as risk and profile analysis, reputation and gathering of information about the borrower, in order to minimize the risk of default.

Besides the uncertainty arising from this contract law system, there is the so-called crisis of the judiciary. The excessive delay in resolving disputes in the judicial environment has become a major problem. The cause goes beyond the accumulation of lawsuits because the very system of conflict resolution has proven to be inefficient, with claims taking five to six years to be resolved, on average. Boaventura Santos (2007) points out two forms of delays that have affected the Brazilian judicial system: a systematic form, due to the bureaucracy and legalism; and an active form, resulting from the imposition of obstacles by law operators (judges, officials or parties) to prevent the normal sequence of procedures from ending up the dispute.

This situation must also be attributed to the national culture of litigation. According to the report “Justice in Numbers 2014” (Justica em Números 2014) elaborated by the National Council of Justice (CNJ), in 2013, the Brazilian justice system accumulated 95.14 million...
pending lawsuits, notwithstanding several efforts to promote other forms of dispute resolution. When a dispute arises, the first natural thought of many Brazilians is to contend in court. One should add to this the relative newness of the alternative forms of resolution (such as arbitration, mediation etc.). The Law of Arbitration, for example, was enacted in 1996, and causes popular hostility even now. Moreover, access to these alternative mechanisms is relatively expensive, which inhibits their widespread adoption.

In a study that focused on the agribusiness of beef exporters in Brazil, Caleman and Zylbersztajn (2012) pointed out the lack of effective institutions to support transactions between farmers and meatpacking industries, which has generated an increased perception of transaction risk. A high number of respondents claimed to have a low degree of faith in the judicial system, mentioning delay, current legislation on credits, and low effectiveness of decisions, among other reasons. Thus, the study concluded that judicial mechanisms do not provide necessary guarantees for transactions, the authors noting that this institutional aspect should be taken into consideration in the analysis of organizational failures and organizational strategy.

From the perspective of NIE, this inefficient justice scenario and the weakness of dispute resolution alternatives affect the economy of the contracts because the contract design takes into account the capacity of coercion of the courts and most effective forms of dispute resolution (Zylbersztajn & Sztajn, 2005). In this sense, the Brazilian context seems to provide a legal institutional environment that generates high transaction costs for its failure to safeguard the contractual interests of the agents. When the rules of the game (North, 1990) are not clear and secure, it increases the uncertainty in transactions, raising the costs to govern them.

As a consequence of this context, agents are forced to adopt their own alternative measures to protect their interests in the transactions, ex ante, ex-post, and during the execution of the contract, to complement the contracts and address the weaknesses of the contract law system for ensuring transactions. A few mechanisms of coordination and guarantee are covered in the next section, based on previous studies.

4. ALTERNATIVE MECHANISMS OF COORDINATION AND GUARANTEE OF THE TRANSACTION

Ménard (2002) concludes that contracts, however complex they may be, do not constitute a sufficient tool for regulating the relationship between agents, arguing that other forms of control and coordination should be adopted as a complement to contracts.

Some studies suggest that this occurs through the behavior of organizations in the adoption of mechanisms ex ante (pre-contractual), ex post (post-contractual), and during the course of, the relationship (contractual) with trading partners, collectively or privately. A clear example of collective mechanism of coordination and control is the development of sectoral councils in Brazilian agribusiness. The Council of Farmers of Sugarcane and Alcohol of the State of São Paulo (CONSECANA), for example, was created in 1999 to regulate the relations between economic agents of this sector, ensuring a good relationship between suppliers and industries and improvement of product quality and dispute resolution (Belik et al., 2012). Through a very detailed manual, CONSECANA defines the rules of quality of sugarcane and sets standards and recommendations for contractual negotiation between suppliers and industries. During the crop year, it discloses the estimated average

http://www.cnj.jus.br/programas-de-a-a-z/eficiencia-modernizacao-e-transparencia/pj-justica-em-numeros/relatorios.
price of the kilogram of Total Recoverable Sugar (TRS), to serve as reference for invoicing and calculation of advance payments. It is also competent to homologate equipment, analytical instruments, and reagents used in quality analysis of sugarcane. All these measures indicate a guiding role of the council over the relations among its members to mitigate risks and conflicts and standardize contracts, procedures, and commercial practices. Belik et al. (2012) highlight the importance of CONSECANA in disciplining the relations of its members, becoming the main price reference in the sector and the factor responsible for minimizing conflicts between suppliers and industrials, allowing for more equal sharing of profit and losses among agents.

Following similar thought, Paulillo and Bouroullec (2010), in a study of coordination mechanisms in citrus fair trade relations involving Brazilian organizations of growers and international importers, also identified a form of collective monitoring that complements the contracts involved and assists in minimizing risks in an uncertain institutional environment: ad hoc institutions. These are autonomous entities that coordinate a significant subset of decisions among the involved parties, working practically as a department. Such ad hoc institutions establish the requirements of fair trade of orange juice, as well as commercial standards for transactions of the supply of orange juice, such as minimum price, payment terms, and financing.

These entities also act as certifiers of growers and orange juice importers in fair trade, carefully selecting the organizations that are kept in this market. The growers and importers must adhere to the requirements of the ad hoc institution and follow commercial standards set for carrying out the transactions. The ad hoc institutions also play a supervisory role over compliance with fair trade standards by tracking products, through labeling and documentation. In addition, they require that the purchase and sale transactions of orange juice are formalized through contracts, which serve as control instruments of negotiated volumes and other criteria established by the ad hoc institutions (Bouroullec & Paulillo, 2010). The observance of these standards by the organizations, the adhesion to the requirements necessary for the certification, and the choice of certified partners for the transaction denote the practice of using mechanisms adopted at a collective level for the purpose of minimizing risks and transaction costs and improving the efficiency of operations.

These collective measures seem consistent with the unobservable mechanisms mentioned by Ménard, referring to those crystalized in certain authorities also called “order” or “private governance”, with their own legal existence, to which one delegates the power to decide on a subclass of entities (Bouroullec & Paulillo, 2010).

At an individual level, studies also indicate that companies adopt proper mechanisms to coordinate relationships with their trading partners in an attempt to give greater assurance to their transactions. These are referred to as private mechanisms of coordination.

In a foreign study, Arrunãda (2000) examined private measures adopted by large retailers that provide efficiency to relationships with their suppliers, exerting a quasi-judicial role with contracts. In a pre-contractual moment, a refined and careful selection of the supplier's profile is made, checking up on their financial capacity, operational capacity, and administrative organization. Once the original contract is signed, each year, a new instrument (framework contract) is signed between the parties with necessary adaptations, a mechanism that regulates the relationship more efficiently. Short payment periods are practiced to facilitate monitoring and supervision. Performance failures are economically sanctioned with

delay or retention of the payment, or discounts in case of defective products. There is an internal hierarchical structure for renegotiation and dispute resolution, to whom suppliers can present their complaints to be solved. Ungrounded claims are subject to fines.

These measures, which are practiced privately in relationships between companies, act as factors for reduction of risks and improvement of efficiency. In the Brazilian context, some similar examples may be brought to the analysis. Caleman and Zylbersztajn (2012) examined transactions between meatpacking industries and farmers of Mato Grosso do Sul, and noted a lack of effective institutions to support transactions in the agribusiness system, pointing out the privately adopted practices to create guarantees, such as the practice of demanding payment in cash to farmers to address problems arising from non-payment by industries, with the possibility of anticipated discounting of rural promissory notes (RPNs) with the banks. Another such practice is the use of intermediaries to carry out the transaction, which, based on trust, minimizes the asymmetry of information related to prices, scale, and performance guarantees, etc.

With regard to contracts of rural credit, Almeida and Zylbersztajn (2012) identified private mechanisms adopted by agents to reduce information asymmetry and moral hazard. The use of selection filters through a rigorous analysis of the borrower’s profile, based on public and private information, demand of collateral (mortgage, guarantee, pledge) added to the record of Rural Product Securities (RPS) in the property registry to ensure exclusive credit, analysis of payment capacity, and good credit scores, trust, reputation in the market and social network, are some examples cited by the authors. They also point out that this selection process associated with the demand of guarantees has driven breaches in banks and in credit and production cooperatives to low levels, which indicates the efficiency of the adoption of these private mechanisms of coordination in such transactions. Another interesting finding was the practice of private renegotiating mechanisms in banks and credit cooperatives to resolve contractual breaches.

Another classic example occurs in the poultry industry. The meatpacking industry coordinates the entire production chain with the producer, providing selected strain of chicks, feed, veterinary care, and even medicine. The producer, in turn, has the guarantee of purchase. At the end of the fattening cycle, payment for the chickens is made according to the efficiency rates achieved in the process, considering the mortality rate, fattening time, etc. (Nogueira, 2003). This presents a way to eliminate much of the risk, because the industry maintains control in all production stages, from production of feed to the slaughter, processing, and exporting operation. This model also eliminates costs involved with market transactions for both parties, such as the monitoring and price negotiations and the search for buyers and logistic operations (Zanella, Milk, Fiates & Carlo, 2013).

As an example from the technology industry, in a study on the relationship between software houses and consulting firms that provide software implementation services in Brazil, Rocha and Bataglia (2015) mention an interesting private mechanism of dispute resolution. In a procedure referred to as hierarchical escalation, a concept similar to the internal negotiation structure studied by Arruñada (2000), disputes that arise at the local level and not resolved after discussions between their representatives, are gradually allocated to higher hierarchical levels, up to, for example, the presidency. If in this instance a consensus is not achieved, the matter is taken to an even higher level, potentially involving global leaders from both multinational companies. The basic assumption is that higher levels are provided with more information, experience, understanding of the strategic importance of the relationship
and power over the decision to allocate resources. In an instance of an escalation, dispute resolution committees are formed with the participation of both companies’ members.

In addition, related to the previous example, other private mechanisms of control and coordination deserve mention. Consulting firms must sign with software houses another instrument, known as a **training agreement**, through which consultants should invest in technical courses offered by software house professionals to obtain knowledge on the technology to be implemented with their clients. Through this measure, software houses ensure the quality of services offered to end users, minimizing risks related to the potential provision of poor service by consulting firms. Rocha and Bataglia (2015) also address the case in which the parties allocate a percentage of the software sales to a **Business Development Fund**, by mutual agreement. The objective is to provide a fund to subsidize specific actions in market development, which will benefit both parties. **Co-development agreements** based on a collaborative innovation system are also entered into between the parties, ensuring intellectual property and knowledge transfer (Rock & Bataglia, 2015). This type of agreement, exemplifying alignment mechanisms and a convergence of interests, provides coordination for measures of the relationship, quality assurance, increase of mutual dependence, and consequent mitigation of opportunistic behavior, by reducing transaction costs. Table 2 summarizes the mechanisms discussed herein.

**Table 2 – Examples of Collective and Private Mechanisms of Coordination**

<table>
<thead>
<tr>
<th>Mechanism</th>
<th>Nature</th>
<th>Type</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sectoral councils</td>
<td>Collective</td>
<td>Contractual; Post-contractual</td>
<td>Guarantee of good relationship between suppliers and buyers; product quality improvement; standardization of commercial practices; and dispute resolution.</td>
</tr>
<tr>
<td>Ad hoc institutions</td>
<td>Collective</td>
<td>Pre-contractual; Contractual; Post-contractual</td>
<td>Determination of commercial standards for transactions; minimum contract terms; agent certification; and quality inspection.</td>
</tr>
<tr>
<td>Payment guarantee</td>
<td>Private</td>
<td>Pre-contractual; Contractual</td>
<td>Demand for payment in cash for product sales; anticipated discount of rural promissory notes with banks; and demand for stringent collaterals (mortgage, pledge, guarantee).</td>
</tr>
<tr>
<td>Use of intermediaries</td>
<td>Private</td>
<td>Pre-contractual; Contractual</td>
<td>Autonomous and trustable professionals with information on market prices; mediating; and monitoring transactions.</td>
</tr>
<tr>
<td>Partners selection filter</td>
<td>Private</td>
<td>Pre-contractual</td>
<td>Analysis of payment capacity and good credit scores; trust; and reputation in the market and social environment.</td>
</tr>
</tbody>
</table>
Production chain coordination | Private | Pre-contractual; Contractual | Entire production chain coordinated by one of the parties, who provides all inputs and materials for the production.

Private dispute resolution | Private | Contractual Post-contractual | Renegotiation measures in contractual breaches, hierarchical escalation; dispute resolution committees.

Quality assurance | Private | Pre-contractual; Contractual | Training agreement; analysis of operational capacity; and co-development agreement.

Interests convergence mechanisms | Private | Contractual | Co-development agreement; business development funds.

**Fonte:** Elaborated by the authors.

### 5. CONCLUSIONS

This study examines the relationship between the Brazilian legal institutional environment, based on contractual law, and the practice of collective or private mechanisms of coordination by companies. The analysis shows that the association made by Williamson (1979, 1991) between contract law and the firms' governance structures is not universally applicable, as it does not consider the peculiarities of legal systems that are different from common law, as is Brazil’s. Even in similar law regimes, the institutional context of each country needs to be taken into consideration, considering how their respective contract laws came into being, as well as development and application modes, as this environment limits the forms of contract coordination and the strategic objectives of businesses (Coase, 1937).

The analysis also asserts that the contract as a mechanism of coordination and guarantee has its limitations, not only because of the bounded rationality of agents and the incompleteness inherent in its nature, but also because of the uncertainty caused by the environment in which it is exercised. In the Brazilian legal environment, such uncertainty is further aggravated by unstable and inefficient legal and judicial institutions, with a deficient contract law system, pointing to the behavior of organizations in seeking alternative forms of guarantee of transactions. Some examples of existing studies were brought to the discussion to illustrate how companies coordinate transactions privately or collectively, as a way to strengthen the weaknesses involved in contractual relationships. It was observed that there is a creative and diversified array of measures taken before, during, and after the contract, with the aim of reducing transaction costs and minimizing risks of information asymmetry or opportunistic behavior of agents.

Understanding how contracts can be arranged and coordinated following the characteristics of the institutional environment is important because the latter influences the results for different organizations (Zylbersztajn & Sztajn, 2005), justifying the importance of the issue for strategic study. While it is farfetched to consider that there exists a legal system that works perfectly, with access to the judicial system for low cost, most contract...
management and dispute resolution is dealt with directly by the parties, under private control (Williamson, 2000). Therefore, the central question becomes the need to come up with good contractual agreements between the parties, rather than rely on contract law capable of regulating satisfactorily all situations and objectives. The most appropriate arrangements seem to be those that indicate the preponderance of economic interests involved in the contracts, namely the perception of the parties on the economic importance in maintaining and fulfilling the contract in favor of future transactions, notwithstanding such future value is not measurable in present. Therefore, this leads to the reflection that efficient contractual arrangements should establish high levels of perception of future value resulting from a good contractual relationship exercised in the present by the parties. This reasoning highlights the importance of relational contracts, in which a complex of transactions makes a relationship based on mutual dependency and trust (Williamson, 1991) with future implications for economic agents.

In this context, this study contributes to the literature of TCE through conceptual thinking that allows reflection on the deficiencies of the legal system in supporting transactions, requiring other compensatory mechanisms for institutional failures. Thus, an expansion of the theory is imposed, to explore more deeply the efficient contractual arrangements to guarantee transaction beyond the contract and the contract law that governs them, whose focus lies on contractual models that generate future value sufficiently perceptible by the parties.

Following this thought, this study illuminates practical steps for managers, such as identifying the weaknesses and uncertainties of the institutional environment in which they function, and taking strategic action to develop the best contractual arrangements with efficient mechanisms of control, coordination, guarantee of transaction, and internal dispute resolution, through an assessment of present and future economic implications involved in each transaction.

From the perspective of public administration, to allow for a more stable institutional environment for conducting transactions, this paper suggests the development of incentive and public information mechanisms and entities on the alternative methods of dispute resolution (such as mediation and arbitration), stimulating its easy accessibility. In addition, this study recommends the promotion of the improvement of judiciary system to enhance its efficiency and effectiveness, and to lead to greater standardization of jurisprudential understanding for the mitigation of the uncertainty of judicial decisions.

Despite the reflections and discussions to which the current study contributes, it is limited by its theoretical nature. It opens the way for future studies to empirically operationalize the assumptions discussed herein, with the purpose of measuring the uncertainty created by the Brazilian legal institutional environment for contractual support of transactions, its influence on governance choices and different contractual arrangements, and the perception of future economic value of the transaction. In addition, future research is recommended on the resulting practice of creating and using collective or private coordination mechanisms, as well as their effectiveness in reducing transaction costs. Findings from this study can also be extended to research in other countries, with different legal and institutional environments and particularities of their contractual laws, to verify the impact on transaction costs.

As well stated by Azevedo (2005), "the agenda is open, and the results look promising" (p. 132).
REFERENCES


