On the Invalidation of Terms in Contracts of Adhesion

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Note

On the Invalidation of Terms in Contracts of Adhesion

Andrew Tutt†

This Note argues that judges should invalidate terms in contracts of adhesion that place the risk of loss on the costlier cost-avoider or that grant an option to one of the parties to impose non-reciprocal costs on the other. It goes on to justify this rule, arguing that it minimizes both the primary and secondary costs of contracts of adhesion.

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Introduction

Contracts of "adhesion"\(^1\) remain ubiquitous.\(^2\) Yet courts still struggle to decide when to invalidate their terms.\(^3\) Even as courts continue to grapple with the enforceability question in high stakes consumer contracts cases, they lack a systematic approach to deciding when the terms in these contracts should be overridden.\(^4\) When, if ever, should courts refuse to enforce a term set out in a contract of adhesion?\(^5\)

1. The phrase "contract of adhesion" was introduced into the American legal vocabulary by Edwin W. Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 & n.106 (1919) (noting a similar usage in international law), but made famous by Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 636 (1943) and, later, Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173 (1983). In a contract of adhesion, the contract is drawn up by the seller and the purchaser, who merely "adheres" to it, has little choice as to its terms.


3. See, e.g., Harry G. Prince, *Unconscionability in California: A Need for Restraint and Consistency*, 46 HASTINGS L.J. 459, 472-79 (1995) (describing varying approaches undertaken by courts in assessing procedural and substantive elements of unconscionability); Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1464-66 (1989) (outlining different judicial responses to insurance policies as adhesion contracts); James J. White, *Form Contracts Under Revised Article 2*, 75 WASH. U. L.Q. 315, 346-48 (1997) (analyzing different statutory approaches to invalidating retail contracts). But see Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 433 (2002) (arguing that "the law ultimately has coalesced around a workable set of rules that protects consumers from surprise and unfair terms while supporting the economically beneficial use of standard forms"). Yet when Hillman and Rachlinski ultimately describe this "workable set of rules" they present not decision rules, but legal doctrines. See id. at 456 ("The courts have developed legal doctrines that curb form abuse largely from three sources: the unconscionability doctrine, the Restatement (Second) of Contracts section 211(3), and the doctrine of reasonable expectations."). These terms—unconscionability, reasonable expectations, and the like—are merely labels. They have no meaning without an underlying theory. While these doctrines may be the legal "hooks" through which courts channel decision rules, they do not themselves decide the cases.

4. This lack of consensus was on display recently in *AT&T Mobility LLC v. Concepcion*, a high profile Supreme Court case from the 2011 Term. 131 S. Ct. 1740 (2011). In *Concepcion*, five justices held that California's rule invalidating contract terms designed to "deliberately cheat large numbers of consumers out of individually small sums of money" was grounded in no objectively rational theory of unenforceability. Id. at 1746-47. The rule, in other words, was no different than any other arbitrary reason the California courts might have given for striking an arbitration clause from a contract of adhesion. Id. at 1747. The four-justice dissent in *Concepcion* disagreed, arguing that the rule was as justified as it was obvious. Id. at 1760-62 (Breyer, J., dissenting). But rather than a thoroughgoing endorsement of California's rule, the dissent confined its discussion of the economic rationality of the California rule to a pair of sentences, sidestepping tricky questions of efficiency and fairness. Id. at 1761.

5. For a sampling of proposals, see, for example, Korobkin, supra note 2, at 1245 (arguing for a hybrid approach in which legislatures impose mandatory terms and courts exercise limited judicial review of seller provided terms, thus avoiding the promulgation of a general theory, recommending instead an institutional design); Rakoff, supra note 1, at 1242 (arguing that courts should enforce
This Note offers a rule for deciding when a term set out in a contract of adhesion should not be enforced. In the context of a form consumer contract, where a term reduces the overall surplus associated with the contract—either by placing the risk of loss on the class for whom the prevention of the loss is more costly, or allowing one class to behave strategically at the expense of the other—courts should not enforce it. This straightforward, economically-grounded, consumer welfare oriented rule could help to bring coherence to this unsettled area of law, and provide sound guidance to the Consumer Financial Protection Bureau, an agency that now possesses sweeping powers to regulate consumer contracts.

The remainder of this Note explains why this rule is superior to other approaches put forth for deciding when to invalidate terms in contracts of adhesion. Part I explains what contracts of adhesion are, how they differ from the conventional contract paradigm, and why scholars have not yet advanced a satisfactory theory for invalidating their terms. Part II then argues that striking out terms in contracts of adhesion that place the risk of loss on the class or category for whom prevention is more costly maximizes social welfare.

I. An Introduction to Contracts of Adhesion

Contracts of adhesion are form contracts, offered on a take-it-or-leave-it basis, usually by a seller of a good or service. Consumers enter into contracts of adhesion more than any other kind of contract. Indeed, for many standard terms when the form provider can establish that they are "important to the preservation of the ability of firms to initiate new enterprises and practices, and that such enforcement thereby contributes concretely to the functioning of business as a social force independent of governmental control"); and Slawson, supra note 2 (presenting part of the economic explanation of why form contracts may be problematic but offering as the only guidance to courts, in determining what terms to enforce, the suggestion that the terms be fair, democratic, and in the public interest).

6. Throughout this Note, the terms efficiency and welfare-maximizing are meant to refer to the overall surplus associated with the contract, to the parties to the contract.

7. See Korobkin, supra note 2, at 1284 (arguing that courts should consider socially inefficient terms substantively unconscionable); cf. Guido Calabresi & Jon T. Hirschoff, Toward a Test for Strict Liability in Torts, 81 YALE L.J. 1055, 1060 (1972) (suggesting that in the context of any strict liability regime (of which contracting is one), "[t]he question for the court [of who should bear the cost of the loss] reduces to a search for the cheapest cost avoider"); Louis Kaplow & Steven Shavell, Fairness Versus Welfare, 114 HARV. L. REV. 961, 1161-62 (2001) (suggesting that "one would refer to the parties’ mutually ideal complete contract as a source for terms that would make the parties better off" in deciding how to rewrite contracts of adhesion). Note that the "risk of loss" idea here presented is meant to encompass the risks associated with opportunistic behavior as well. See Lucian A. Bebchuk & Richard A. Posner, One-Sided Contracts in Competitive Consumer Markets, 104 MICH. L. REV. 827, 830 (2006) (noting that "the optimal set of contract terms does not depend only on the relative costs and benefits associated with particular terms. It also depends on the relative propensity of the parties to behave opportunistically"); Robert E. Scott & George G. Triantis, Embedded Options and the Case Against Compensation in Contract Law, 104 COLUM. L. REV. 1428, 1460 (2004) (describing the option to behave opportunistically as part of the risk of loss for which all contracts must account).


10. See sources cited supra note 2.
consumers it is possible they have never entered into the “ordinary” two-party negotiated contracts taught in a first-year contracts course. Yet even though contracts of adhesion are the most common kinds of contracts, they differ from negotiated contracts in one critical respect—because they are offered on a take-it-or-leave-it basis, the adhering party generally enters into them without manifesting knowing and voluntary consent to all their terms.\textsuperscript{11}

This difference between contract doctrine’s vision of the contract as an agreement bargained over by two fully informed rational parties and the reality of a world where one party is ordinarily unable to negotiate any of the contract’s terms has been a longstanding tension in the law of contracts. On one hand, contracts of adhesion are a welfare-enhancing feature of modern commercial life. For firms, the very uniformity and rigidity of such contracts makes them valuable as a means of reducing agency costs and fixing expectations of future obligations.\textsuperscript{12} For consumers, not having to bargain is valuable as well. The costs of reading, understanding, and bargaining over every term in such contracts would be enormous.\textsuperscript{13} On the other hand, contracts of adhesion carry their own special risks. To those who value fairness, when these contracts contain exceptionally one-sided and surprising terms, they appear deeply unfair.\textsuperscript{14} To those who mainly prize social-welfare, the contracts can be seen as reducing overall consumer welfare to the extent that they possess inefficient terms.

Whatever one’s thoughts on their balance of fairness and unfairness or benefits and costs, scholars and courts have failed to generate an adequate theory—and therefore a useful and rational rule—for deciding when (if ever) it is appropriate to invalidate provisions in contracts of adhesion.\textsuperscript{15} As one scholar recently put it, “[i]n few other fields, even in law, has conventional thought been so fused in amber.”\textsuperscript{16} Courts invalidate terms because they are “unconscionable,” or invalidate terms that impose unfair surprise, or invalidate

\textsuperscript{11} See Rakoff, supra note 1, at 1179-80. There is no hard and fast rule about what constitutes a contract of adhesion. Courts generally use a variety of criteria for determining when a contract possesses adhesive qualities. Even if there is ambiguity at the edges, however, there is consensus that insurance policies, real estate contracts, cell phone contracts, cable contracts, consumer products contracts, software licenses, and “clickwrap” and “browsewrap” agreements are firmly in the “adhesion” category. See Robert L. Oakley, Fairness in Electronic Contracting: Minimum Standards for Non-Negotiated Contracts, 42 HOUS. L. REV. 1041, 1053 (2005) and sources cited therein, describing indicia of adhesion, such as presentation in a standard form, use in consumer transactions, drafting for a generalized rather than particularized commercial transaction, and offered on a take-it-or-leave-it basis.

\textsuperscript{12} The firm’s agents, for example, cannot vary the terms in a manner that is harmful to the firm. See, e.g., Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305, 308 (1976) (discussing agency costs and how firms attempt to reduce them).

\textsuperscript{13} See, e.g., Rakoff, supra note 1, at 1226.


\textsuperscript{15} See sources cited supra note 3.

Contracts of Adhesion
terms that are against public policy, but because courts and scholars have not managed to provide a framework for understanding what aspects of a contract of adhesion should be legally relevant to its enforceability, the reasons courts give for labeling a contract term unconscionable, unfairly surprising, or against public policy, remain markedly inconsistent.17

A. How the Debate Over Enforceability Became “Frozen in Amber”

Three stumbling blocks have thwarted progress in the development of a framework for deciding when to invalidate terms in contracts of adhesion. First is the persistence of consent-based theories of adhesion. Because consent forms the bedrock justification for ordinary contract enforcement, many scholars have argued and continue to argue that consent can workably support the enforcement (or justify the non-enforcement) of contracts of adhesion as well.18 But because one of the primary benefits of contracts of adhesion is that the parties are not required to negotiate and consent to every term, these theories are puzzling—they would base invalidation on the one feature that most prominently sets these contracts apart from negotiated contracts. The second stumbling block is the continuing focus on whether terms in contracts of adhesion are likely to be generally efficient or inefficient. This argument, which animates so much of the scholarship in this area, has one central flaw—whether the question is answered one way or the other does little to help courts fashion a rule for deciding actual cases. Finally, the third and strongest roadblock to putting forward a theory for invalidating terms in contracts of adhesion is that it is nearly impossible to tell when terms are fair or unfair. Yet this final argument is flawed as well, because the rule for invalidating terms in contracts of adhesion need not be perfect, it need only be the best rule among the realm of available alternatives.


1. The Puzzling Persistence of Consent-Based Theories

First among the stumbling blocks to developing a framework for invalidating terms in contracts of adhesion has been many courts' and scholars' desire to forcibly fit contracts of adhesion into the broader family of negotiated contracts, even though it is not clear that contracts of adhesion belong there. Supporters of this view focus their analysis of whether terms in a contract of adhesion should be enforced based on the individuated consent and bargaining power of the two parties to the agreement. Their goal is to reach the question of whether the consumer knowingly and rationally understood what the terms in the contract he or she was signing meant. This framework is best exemplified by the famous (or infamous) case of Williams v. Walker-Thomas Furniture Company, where Judge J. Skelly Wright focused almost entirely on whether the individual party to the contract—who had little formal education—gave a legally valid consent to the Walker-Thomas Furniture Company's contract terms.

This approach is problematic for a number of reasons. It will either be underinclusive and incredibly costly to administer or overinclusive and entirely unmoored from pertinent economic consideration. If courts were to administer unconscionability analysis on a case-by-case basis like this, it would chill the market for consumer contracts and raise the cost of litigation immensely. Parties would have incentives to cheat and gamble on litigation. Courts would have to attempt to discern the individual legal capacities of the parties agreeing to a contract of adhesion on a case-by-case basis. While discerning the consent of the parties is central to ordinary negotiated contracts—where the terms are particular to the two parties who negotiated them—it makes little sense for form consumer contracts that are entered into by potentially thousands of consumers.

Some scholars try to rehabilitate consent-based theories by arguing that they can be broadened to the idea of an "objective" mass-market consent. Rather than assessing the legal capacities of the particular parties before the court, courts could look to the nature of the instrument and decide whether the term is generally unenforceable because the term is unfairly surprising or unconscionable to too many consumers. Some theorists have advocated this approach, arguing that Courts should invalidate terms in contracts of adhesion that are "radically unexpected." The problem with this approach and others

21. Barnett, supra note 14, at 637 ("If, therefore, a realistic interpretation of what clicking 'I agree' means is 'I agree to be legally bound to (unread) terms that are not radically unexpected,' then that—and nothing more—is what has been consented to objectively."); see also Joshua Fairfield, The Cost of Consent: Optimal Standardization in the Law of Contract, 58 EMORY L.J. 1401, 1447 (2009) ("I posit that courts are often not using unconscionability analysis to target standard terms or standardized contracts. A contract that truly reflects the industry standard—and thus is the most standardized—is generally safe from unconscionability attack.").
that attempt to generalize a consent-based understanding is that it essentially unmoors contract doctrine from welfare and fairness considerations and says that contract enforceability should really depend only on the amount of information consumers generally possess. For instance, when courts attempt to apply the unfair surprise standard by looking to the terms that are ordinarily employed in the relevant market the court unintentionally creates a paradox—the more commonly firms employ a socially inefficient term the more likely courts will be to uphold it because consumers are not surprised by it.\textsuperscript{22}

Moreover, it seems that consent only enters the analysis as a relevant consideration because contracts of adhesion in form resemble “contracts.” But in substance contracts of adhesion are nothing like negotiated contracts. Because they are meant to be employed across potentially thousands of consumers, both firms and consumers prefer that consumers not hire attorneys to pore over the boilerplate in every contract that they sign and try to get the terms changed. In other words, both consumers and firms would rather not require that consumers negotiate and consent to every term in the contracts that they sign. This makes the idea that terms in such contracts should be enforced or invalidated on the basis of “consent” to any particular term puzzling.\textsuperscript{23}

Moreover, it is worth noting that staking out a position that contracts of adhesion should be scrutinized more carefully and judicially altered more often than ordinary contracts is not inconsistent with a belief in the “freedom to contract” under most other circumstances.\textsuperscript{24} This is because the elements of contract—formation, performance, and breach—are conceptually fluid. Contracts of adhesion exist on one of the distant poles of this spectrum, involving little in the way of negotiation and informed consent. Thus, to the objection that invalidating terms in these contracts might deprive consumers of the ability to specifically contract for desired terms, there are two counterarguments. First, such terms can still be obtained through another form—a contract that does not possess the indicia of adhesion. Second, to the extent that invalidating inefficient terms impinges on autonomy, one is left to

\textsuperscript{22} Cf. Louis Kaplow, Direct Versus Communications-Based Prohibitions on Price Fixing, 3 J. LEGAL ANALYSIS 449, 453 (2011) (describing a similar phenomenon in antitrust law wherein under current law, the markets where it is easiest for rivals to set high prices in parallel are actually less, rather than more, likely to give rise to liability). This paradox is also a problem in Fourth Amendment “reasonable expectations of privacy” jurisprudence. The Court and scholars have often worried about the idea that expectations of privacy are intimately tied to what the judiciary ultimately allows the State to do, creating a kind of paradox. See United States v. Jones, 132 S. Ct. 945, 962 (2012) (Alito, J., concurring) (“the Katz expectation-of-privacy test . . . involves a degree of circularity”); Kyllo v. United States, 533 U.S. 27, 34 (2001) (observing that the test “has often been criticized as circular”); Priscilla J. Smith et al., When Machines Are Watching: How Warrantless Use of GPS Surveillance Technology Violates the Fourth Amendment Right Against Unreasonable Searches, 121 YALE L.J. ONLINE 177, 194 (2011) (arguing courts can and should avoid interpretations that render the test circular).

\textsuperscript{23} See, e.g., Braucher, supra note 18, at 716; Fairfield, supra note 21, at 1426.

\textsuperscript{24} To this notion even Randy Barnett, a prominent libertarian legal scholar, agrees. See Barnett, supra note 14, at 637 (“[T]he enforcement of some form terms may be subject to additional constraints that would not apply to expressly negotiated terms.”).
ask how often a fully informed rational party would voluntarily choose to contract for an inefficient term. While some contractual terms can be difficult to value accurately (a problem that often arises in the context of consideration doctrine) many inefficient clauses in contracts of adhesion are susceptible to valuation and therefore may be capable of intelligent judicial appraisal ex post.

2. The Wrong Question: On the Likely Efficiency of Terms in Contracts of Adhesion

Scholars of law and economics, recognizing the distinction between negotiated contracts and contracts of adhesion, shifted the debate from one about whether a particular consumer gave a legally valid consent to a discussion about whether the terms in contracts of adhesion are generally likely or unlikely to be efficient. Thus, the perspective of most (but not all) of those who analyze contracts of adhesion has shifted—from an atomized debate about whether individual consumers gave legally valid consent to individual contract terms—to a market-based view. Law and economics scholars began to debate market rationality. Many argued that the terms in the consumer contract are part of the good or service over which firms in the market compete. As such, either competition to offer the best goods at the lowest price, or the desire for monopoly profits, would drive sellers to make their terms efficient.


With which this Note primarily concerns itself. See Kaplow & Shavell, supra note 7, at 1160-61 (arguing that "notions of fairness...are likely to lead us astray by favoring legal rules that make both parties worse off—for no apparent reason."). But see Randy E. Barnett, ...And Contractual Consent, 3 S. Cal. Interdisc. L.J. 421 (1993) (providing a spirited defense of other methods of arguments as at least equal in legitimacy to law-and-economics arguments).

28. See, e.g., Bechuck & Posner, supra note 7, at 828-29 (making this point); Kaplow & Shavell, supra note 7, at 1160 n.467 (making the same point).
Under this framework, many scholars concluded that contracts of adhesion should always be enforced because their terms are likely to be systematically efficient. This avoids the need to analyze whether there was sufficient "consent" to the contract's terms.

The problem with this view is that unfair terms frequently appear in contracts of adhesion. Thus, the trend in modern scholarship has been to attempt to disentangle this contradiction. While economic theorists argue that form consumer contracts are efficient almost all the time, a large number of consumer contracts appear surprisingly inequitable.  

As such, contracts theorists have offered a number of rationales for the observed divergence between economic theory and actual contract terms. First, behaviorists argue that systematic cognitive biases mean that consumers are unable to adequately process unfair terms and that therefore the terms are likely to be inefficient in settings where those errors are made. On the other hand, old-style law and economics scholars have argued that the unfair terms phenomenon arises from features of the market for contracts that cannot be directly observed. Either much of the market for contracts of adhesion trades on reputation—and therefore, an implicit promise by drafters that they will not enforce their one-sided terms—or instead on implicit compensation for failing to embed an unfair term into the product itself. As an example of this latter phenomenon, a consumer contract might bar the copying and redistribution of a particular piece of intellectual property rather than cause the program to disable itself when copying or redistribution are attempted. Under these theories, the terms may still be efficient even though they appear inefficient on their surface.

Alexander Bickel once famously remarked "[n]o answer is what the wrong question begets." He could easily have been referring to this captious debate. Because even if we answered the question of whether or not contracts of adhesion are likely to possess efficient terms, that still lends little insight into how a court should decide whether a specific term challenged in a specific contract of adhesion should or should not be held unenforceable. While the likelihood of inefficient terms might tell us something about the accuracy of judicial decisions (whether we are invalidating too many terms or too few), it
gives us no way of improving their precision (whether we are invalidating the right terms).

Thus, while much time and effort has been devoted to arguing about whether the terms in contracts of adhesion are generally likely to be efficient or inefficient, courts have been left to struggle to answer the question of whether the specific term in the specific contract before the court should be enforced. Their solution has been to fashion ad hoc, largely undertheorized (or, on occasion, entirely theory-less\textsuperscript{35}) legal doctrines combining elements of the market-centric and consent based theories set forth by scholars. Some seem to buy the market-based view in which case the decision in any unconscionability case is an easy one: enforce the terms. Others argue that certain baseline notions of fairness should bound the possible terms that can be placed in such contracts. This Note argues for a third way—that courts should strike terms that are economically inefficient, while preserving terms that, even if "unfair" are not economically inefficient.

3. But Can Courts Really Police the Efficiency of Individual Terms in Contracts of Adhesion?

Perhaps this undue emphasis on consent and markets stems merely from path dependence—arising from an original understanding of contracts of adhesion as tools for the exercise of monopoly or "unequal bargaining" power.\textsuperscript{36} Perhaps it stems from motivated reasoning—a desire to explain why the pervasive culture of contracts of adhesion works (or at least seems to work) well much of the time. After all, perhaps contracts of adhesion work well all of the time and therefore courts should ignore their intuitions about fairness and welfare because those intuitions are wrong—the terms are efficient even if they do not look it.

But the more likely reason that scholars avoid treading the dangerous territory of actually proposing an economically grounded judicial rule for...
invalidating terms in contracts of adhesion is that “efficiency” arguments are often thought to be normatively contingent and easily manipulated. They depend “in a major way on what kind of general character we attribute to large numbers of people of whom we have little concrete knowledge.” Whether a given term is efficient or inefficient “all depends on empirical data that no one ever seems to have ready to hand.”

As such, it has been argued, neither a judge in an individual case, nor a scholar in the abstract, could declare a term or category of terms to be efficient or inefficient with any degree of confidence. This insight is often left unstated by scholars but, nevertheless, it is powerful. After all, merely knowing that sellers can shape fine print to favor them and disadvantage buyers—

[D]oes not tell us the extent to which preventing sellers from playing games with fine print should be the focus of the regulator. Protecting against this form of potential abuse may be inconsistent with creating rules that make it easy for sophisticated buyers to search. We need to know something about how powerfully the forces of competition push sellers to offer efficient terms and how much they are tempted to engage in advantage-taking.

But even as powerful as this critique is, scholars and courts have taken it too far because they have used this analysis to argue that because no perfect theory can be put forward guaranteeing that the right terms will be invalidated, no theory should be put forward at all and that everything should be left to the market. But that conclusion—invalidate nothing—is not supported by the critique itself.

First, the empirical argument that courts cannot determine whether a given term is efficient or inefficient is overstated. Many inefficient terms are so palpably inefficient that courts would have no trouble determining them to be so. One need not examine the state of competition in the industry or perform sophisticated longitudinal studies of buyer behavior to conclude, for instance, that form consumer contracts granting merchants the unilateral right to alter the contract’s terms whenever they wish and at no cost should be invalidated.

Second, when scholars and courts use the argument that “all economic arguments are ultimately empirical and potentially unresolvable” to justify not regulating the market at all, they are making their own contingent claim: that markets will do a better job of increasing overall consumer welfare than any other approach. But arguing that efficiency-based decisions are difficult to make does not mean that the market’s decisions are automatically superior.

38. Id. at 600 n.16.
39. Id. at 603.
41. This is a criticism to which the majority in Concepcion is also vulnerable.
Even if it is difficult to tell when terms are inefficient, it does not follow that therefore the market should determine all contract terms. An analogous rationale supports the courts' interventions to remedy antitrust violations. When law and economics scholars argue that terms in contracts of adhesion should never be invalidated, they seem to implicitly ignore the legitimate economic arguments for intervention in the antitrust context. If antitrust is legitimate, there must be at least some occasions when markets fail.\textsuperscript{43} If that is so, it is unclear why the market for terms in contracts of adhesion would be any different.

\textbf{B. What a Theory of Invalidation Requires}

The upshot of this analysis is that, to justify itself, any rule for invalidating the terms in contracts of adhesion must show that it would do a better job than the current regime—in which courts invalidate contracts of adhesion in a haphazard fashion—and would do a better job than many economists' recommended regime—where courts would simply enforce terms in every case.

The goal of this Note is to show that the rule proposed herein is better than the alternatives. My argument is that terms that place the risk of loss on the costlier cost-avoider are almost always inefficient by reducing overall social welfare and therefore, absent significant countervailing considerations should ordinarily be invalidated. My goal is to show that this rule is superior to the current composite of consent and economic theories courts apply, and superior to the always-enforce model favored by many economists. In the Part that follows, I set out and defend this thesis.

\textbf{II. How Placing the Risk of Loss on the Cheapest Cost Avoider Minimizes the Costs of Contracting}

The rule that the terms in contracts of adhesion should be enforced if they place the risk of loss on the class for whom preventing the loss is cheapest, and invalidated otherwise, maximizes social welfare as a matter of both primary and secondary costs.\textsuperscript{44} First, the rule minimizes primary costs by ensuring that

\textsuperscript{43} Even the harshest modern critics of antitrust jurisprudence agree that the antitrust laws—which prevent firms from engaging in certain business techniques that reduce consumer welfare—and their enforcement by courts, has been a success in at least some subset of cases. See Robert H. Bork, The Antitrust Paradox: A Policy at War with Itself 263 (1993) (agreeing that with respect to the longstanding per se rule against classic cartel behavior such as price fixing and market division, antitrust law's "contributions to consumer welfare over the decades have been enormous.").

\textsuperscript{44} As used in this Note, "primary costs" describe the possible advantage-taking in which firms might engage in the direct distribution of the risk of loss between the parties to the contract. "Secondary costs," on the other hand, consist of those costs imposed on society in reacting to and controlling primary costs. Primary costs might be thought of as costs internal to the contract such as costs associated with the contract's risk-distribution and the opportunities for strategic behavior it allows, while secondary costs might be thought external to the contract, such as costs associated with
parties to contracts will expend the optimal amount of resources to prevent contract breaches, thereby maximizing the mutual contractual surplus. Second, the rule minimizes secondary costs by, foremost, directing courts to invalidate the proper terms—terms that are socially inefficient rather than unfair—45—but also by increasing the degree of certainty that parties have as to their legal obligations to one another, curtailing incentives to engage in strategic behavior, dispensing with costly mandatory disclosure rules, and calling on judges to make decisions for which they are institutionally well-suited. Unless judges are going to enforce the provisions of contracts of adhesion in literally every case (an enforcement regime that this Note argues is socially inefficient46), the decision rule presented here is the proper one. The question then turns from what the rule should be to what degree of certainty judges should have in their conclusion that a term is socially inefficient before invalidating it.

Section A explains why an ideal complete contract between buyers and sellers would place the risk of loss on the class best able to prevent it, and then further shows that such contract terms reduce the overall primary cost of such contracts, thereby increasing the overall contractual surplus. Section B explains why such a rule also minimizes secondary contract costs because it discourages only those contracts that are socially suboptimal while imposing fewer false-positives, and demanding less adjudicative resources than other regimes for invalidating terms in contracts of adhesion.

A. Minimization of Primary Costs

In an ideal complete contract, the parties would seek to maximize their mutual gain.47 Ordinarily this entails placing the risk of loss on the party for whom preventing the loss is cheapest. After all, if A can bear the risk more cheaply than B, they are both better off if A bears the risk and they divide the resulting gain. The question of who should bear the risk is made more complicated if A can bear the risk of loss more cheaply than B, but placing the risk of loss on A will allow A to behave opportunistically. If the opportunity to behave strategically allows A to impose costs on B larger than the mutual gain to be expected from placing the risk of loss on A, the contract will need to either include some mechanisms for constraining A’s opportunities to engage in strategic behavior or will need to divide the risk of loss differently so as to avoid the cost of A’s opportunism.

Even though these game-theoretic point-counterpoint concerns can mean that some sophisticated contracts involve complex risk-sharing and bonding

45. See Kaplow & Shavell, supra note 7, at 1160-61.
46. See infra Subsection II.B.1.
47. Kaplow & Shavell, supra note 7, at 1121-22 and sources cited therein (defining the notion of the “mutually ideal complete contract”).
schemes, in consumer contracts it is often far easier to discern that a contract of adhesion inefficiently divides the risk of loss between the parties (either by, for example, placing the risk of loss on the purchaser\textsuperscript{48} or granting the seller an "option" to behave strategically without any obvious bonding measures in place to prevent him from doing so).\textsuperscript{49} The reason is that contracts of adhesion are contracts to which only one of the parties controls (and is often even aware of) the terms. Complex risk-distribution and bonding schemes do not appear because the customer is not likely to even know that such tools for checking the seller's strategic behavior are available.\textsuperscript{50} As such, the vast majority of form consumer contracts merely contain provisions specifying the liabilities of the parties in the event of a breach—i.e., distributing the risk of loss. This should make detecting inefficient terms in form consumer contracts significantly more tractable than detecting inefficient terms in other kinds of contracts.\textsuperscript{51}

Moreover, in archetypical contracts cases, courts enforce the written terms because the parties have negotiated over the division of a contractual surplus known to both. Because they are completely informed and the court is not, there are strong reasons for upholding the terms of bargained contracts. Often parties, more than courts, can better tailor the distribution of risk in negotiated contracts to their own idiosyncratic preferences.\textsuperscript{52} Additionally, even as transactions become more complex and transaction costs increase, the parties themselves often better manage their incentives to engage in strategic behavior in both performance and at the time of litigation.\textsuperscript{53} While the primary risk-distribution in the contract may be suboptimal (in the sense that the overall contractual surplus is not as large as it might have been), because the parties bargained over the terms and freely submitted to them, enforcing them as

\textsuperscript{48} Warranty disclaimers fit this model. See infra Subsection II.A.1.
\textsuperscript{49} Provisions denying plaintiffs the ability to aggregate their claims in light of the possibility of predictable, small contractual breaches are a good example.
\textsuperscript{51} For a more complete discussion of this thesis, see infra Subsection II.B.3.
\textsuperscript{52} This conception is captured by the "bargain model" of contract, characterized by low transaction costs. See Charles J. Goetz & Robert E. Scott, The Mitigation Principle: Toward a General Theory of Contractual Obligation, 69 Va. L. Rev. 967, 968 n.5 (1983) and sources cited therein.
\textsuperscript{53} This is the "transaction costs" model of contract. Id. at 969 n.5. For more detailed analysis, see, for example, Oliver Williamson, Transaction-Cost Economics: The Governance of Contractual Relations, 22 J.L. & Econ. 233 (1979) (describing optimal governance structures for different types of contractual relationships, and arguing that in the case of complex, non-recurrent, idiosyncratic transactions, the optimal regime is either "bilateral" or "trilateral"—essentially, detailed two-party negotiated contracts that potentially include ongoing mutually-selected procedures for enforcement and supervision).
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written is often the best approach. Parties, better than the courts, can determine which contract terms they value.

Because by definition contracts of adhesion are contracts over which the parties have not bargained, and to which one of the parties is assumed to be unable to modify the terms, a different theory must be invoked to justify their enforcement. The terms proposed by the seller structure the contractual relationship as readily as the tort regime structures social relationships. For this reason, in the case of contracts of adhesion, it is not clear that government-mandated rules would be inferior to allowing sellers to write the contracts. In fact, no scholar (at least of law and economics) would argue that a term in a contract of adhesion that places the risk of loss on the party less able to prevent it should be enforceable (unless, for whatever reason, the term is not enforced as written). Rather, they make the more roundabout argument that such terms are not likely to appear in such contracts. They argue that in a rational market, either competition or the desire for monopoly profits will drive sellers to make their terms efficient—which means maximizing the overall contractual surplus and therefore placing risks of loss on the parties best able to prevent them. Thus, their arguments are institutional rather than empirical: courts are not well placed to determine which distribution of risk is cost-minimizing, but, luckily, the market will work itself clean.


55. See, e.g., ROBERT E. SCOTT & JODY S. KRAUS, CONTRACT LAW AND THEORY 23-29 (4th ed. 2007) (noting that courts generally enforce bilateral contracts as written because they think enforcing those promises as written, rather than attempting to improve upon the bargain ex post, enhances allocative efficiency); see also Charles J. Goetz & Robert E. Scott, Enforcing Promises: An Examination of the Basis of Contract, 89 YALE L.J. 1261, 1263-66 & n.18, 1322 (1980) (noting that the traditional justification for enforcing bargained-for exchanges is that it encourages value-maximizing resource allocations, but refining this understanding by noting that enforcement rules themselves affect the amount and kind of promise-making, concluding ultimately that contract law enforces promises where such enforcement is efficient and accurately reflects the party's mutual objectives).

56. See Radin, Reconsidering Boilerplate, supra note 26, at 619, 642-46.

57. And, indeed, government mandated rules are a pervasive feature of many adhesive contracting regimes. Think of the leasing of rental properties, the non-waivability of strict-liability for product defects, and more. As this Note argues, infra, these are manifestations of a government policy that implicitly recognizes that social welfare is optimized when the risk of loss is borne by the party best able to prevent it. See Richard Craswell, Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships, 43 STAN. L. REV. 361, 361-62 (1991) (discussing when such mandatory defaults are efficient, rather than merely redistributive); see also Katz, supra note 50, at 292 (noting that the "correct economic issue" is "whether giving offerors control over the terms of the contract does a better job of minimizing transaction costs than does a centralized presumptive standard").

58. Scholars who do not think that consumer welfare is necessarily the logical foundation of American law possess divergent views. See, e.g., Barnett, supra note 14.

59. See, e.g., Bebchuk & Posner, supra note 7, at 827.

60. See, e.g., id. at 828-29 (making this point); Kaplow & Shavell, supra note 7, at 1160 n.467 (same).
The view advanced in this Note is orthogonal to the foregoing view. The thesis set forth is that if courts could discern that certain terms placed risk on the party for whom bearing the risk was more costly (and it seems that there are at least some situations in which they can), then, in those cases, the courts should invalidate them.

One might be tempted to argue that as to primary costs, there may be instances in which the risk is placed on the party less able to prevent the loss, but that this term also means that the good or service provided comes at a discount. In that instance perhaps, one could argue that courts should not invalidate the term. But, as will be shown in the next Subsection, even if introducing a suboptimal term results in a discount, it is unclear why courts should enforce it. If, as a matter of primary costs, society is indifferent between exchanging the discount for an optimal term, unless there are additional secondary costs associated with invalidating the term, society would be indifferent between invalidating the term or upholding it. Moreover, the opposite is likely to be true: courts are likely to be better able to assess whether a term places the risk on the party less able to bear it than they are to know whether a discount to the consumer perfectly counterbalances its suboptimality. Indeed, discounts may induce consumers to make suboptimal purchasing decisions because such discounts are highly visible while unfavorable terms are hidden.

1. How Cheapest Cost Avoidance Minimizes Primary Costs—An Explanation with Examples

The notion of the party best able to minimize risk may, at first blush, be difficult to conceptualize concretely. The issue is made that much more complicated when dealing with contracts of adhesion because the question is transformed from the archetypical contract case—one in which courts must understand who between two parties engaged in a one-off transaction is the better risk bearer—to another case entirely, one in which the risks of loss (and therefore the costs of such losses) must be aggregated across potentially thousands of consumers. In the context of forum selection clauses, liability waivers, and agreements to submit to binding arbitration, to name some oft-challenged terms, one might reasonably wonder how a court is to determine whether the seller or the purchasers (as a class) were in the better position to minimize the risk of loss when an actual dispute materializes. The answer lies in looking to the contract to see whether the inclusion of the term, on the whole across all purchasers, increases or decreases the overall contractual surplus.

61. See infra Subsection II.A.1.
62. See supra Subsection I.A.2.
63. See Kaplow & Shavell, supra note 7, at 1157 & n.458; Korobkin, supra note 2, at 1234.
64. In this sense, at least, adhesion cases fall closer to tort than contract.
Sometimes this will demand sophisticated analysis. In the context of a forum-selection clause, for example, if the stipulation in the contract is that all lawsuits will be pursued in Miami, even though the purchasers are located in Detroit, it is not necessarily clear that the term should be invalidated for that reason alone. After all, one would postulate that the seller’s additional cost from litigating in Detroit in the absence of such a forum selection clause will be passed on to purchasers. Thus, for at least some purchasers (one imagines the purchasers who do not end up suing the seller), the forum selection clause will constitute a savings in the form of a discount on the contract price. It may even reduce the aggregate cost of the contract overall. For example, it may be systematically cheaper to pursue claims against the seller in Miami, or purchasers might be better able than the seller to determine whether litigation is likely to ensue and be able to plan accordingly.\footnote{Although at this point the seller could just write two different contracts (one with and one without the forum selection clause) and allow purchasers to select between them, thus enhancing the mutual gain for all involved. Cf. Jonathan Klick, supra note 29, at 564-65 (describing how firms can engage in second-degree price discrimination when customers have different time preferences). This is done in a variety of consumer contracts, such as the situation in which a rental car company allows renters to choose whether to purchase optional insurance.}

However, by requiring that claims be pursued in Miami, the seller now has an additional incentive to breach the contract in some circumstances because, on an individual basis, pursuing an individual claim against the seller is a costly transaction. Thus, in assessing the forum-selection clause the court would be tasked with looking beyond the clause itself to the mechanics of the whole contract. If the contract is one in which the seller is tasked with providing a service for which it is possible to systematically obtain an advantage by committing small contract breaches, then—because the cost of litigating in Miami is a barrier to pursuing breach of contract claims—the court should invalidate the forum-selection term, for it divides the risk of breach between the two parties in a suboptimal manner.\footnote{Not because the contract inefficiently divides the risk between the parties, but because it allows one of the parties to impose strategic costs on the other.} If the court strikes down the forum selection clause, the seller will have to charge more to all, but the contractual surplus will rise between the seller and its customers because it can no longer “chisel” on its obligations.\footnote{For more about incentives to chisel on contractual obligations, see Goetz & Scott, supra note 52, at 977-78, and Charles J. Goetz & Robert E. Scott, Principles of Relational Contracts, 67 Va. L. Rev. 1089, 1115 (1981).}

Moreover, this invalidation probably will not create undesirable secondary costs associated with contracting for the good or service. The only contracts that now will not be consummated are contracts that were predicated on a socially suboptimal risk distribution. The contract price will rise, but only because the initial discount was predicated on a wealth-transfer from some unlucky subset of parties against whom the seller was able to extract an inequitable share of the contractual surplus.

\textsuperscript{65}
Or consider the canonical example of an unfair term in contracts of adhesion: the strict liability waiver. Warranty waivers are frequently included in contracts of adhesion, although they are also one of the terms frequently invalidated. The principle that such waivers violate public policy was famously expounded in the case of *Henningsen v. Bloomfield Motors, Inc.*, and at the time of the decision it sent shockwaves through the law of both torts and contracts. As Dean Prosser wrote six years after *Henningsen*: "[the decision ushered in] the most rapid and altogether spectacular overturn of an established rule in the entire history of the law of torts," as state after state adopted strict products liability and also made strict liability unwaivable. Yet, almost twenty-five years after the decision, legal scholars and judges could not agree on the proper rationale for generally invalidating such warranty waivers, and many still argued that "contract should still have a substantial role in allocating product safety risks." In fact, in their Note synthesizing academic commentary and legal decisions after *Henningsen*, Peter Kinkaid and Professor William Stuntz found little suggestion that the waivers were generally invalid because they arose in contracts of adhesion that inefficiently placed the risk of loss on the costlier cost avoider.

*Henningsen* itself entirely ignored that rationale, instead placing great stock in the fact that there were only three automobile manufacturers who together controlled over ninety-percent of the passenger car market. The court suggested that the waiver of liability may have been a product of explicit collusion. Thus, the court in *Henningsen* relied on the same notion that many courts do today—the presence of monopoly or unequal bargaining power. Even Judge Guido Calabresi and Jon Hirschoff's groundbreaking article explaining the notion of the cheapest cost avoider gave only tepid endorsement to *Henningsen*'s holding, though it would seem a canonical instance of striking down a term placing liability on the costlier cost avoider.

After all, *Henningsen* was a case in which an automobile accident was allegedly caused by a product defect in the steering column, precisely the kind of defect that consumers would have difficulty detecting and manufacturers would be well positioned to prevent cheaply. Some have

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71. See Kinkaid & Stuntz, supra note 68, at 1114.
72. Id.
73. Id. at 1113.
75. Id. at 391.
76. Id.
77. See Calabresi & Hirschoff, supra note 7, at 1068.
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criticized the decision—and now more or less nationwide rule—that sellers cannot waive liability for strict liability product defects.\(^7\) And perhaps one might think that the law of contracts could cure this problem—after all, if manufacturers wanted to continue to waive liability they would have to offer a discount on the price of the contract in exchange for keeping the inefficient term.\(^8\)

Yet rational firms would not include the term unless they thought that whatever discount they were required to offer was less costly to the firm than paying liability claims. On this view, it seems plausible that sellers would waive liability because they believed that, by placing the risk of loss on the consumer, at least some consumers would purchase a car who otherwise would not have if they had known the distribution of risk in the fine print. Thus, the non-waivability of strict liability warranty waivers—itself a deviation from traditional unconscionability doctrine as currently applied by courts—fits rather well within a unified theory of contracts of adhesion in which courts invalidate terms that place the risk of loss on the party less able to take cost-justified precautions to prevent the loss.

The examples above illustrate that terms in contracts of adhesion can deviate from the ideal complete contract in two ways. First, by giving incentives to party A to impose costs on party B that party B is not well-positioned to monitor or, alternately, by placing the risk of loss on Party B when avoidance of the loss is more costly for party B than party A. In both cases the terms decrease the overall contractual surplus when aggregated across all transactions between the seller and its purchasers. While one might expect that contracts of adhesion containing suboptimal terms would “price-in” those terms, if we believe sellers behave rationally, they will not include such terms unless they are more profitable than actually writing a contract that minimizes primary costs. Even while these terms mean the seller obtains a larger slice of the smaller contractual “pie” than it would if it bargained for the ideal complete contract, the contract’s terms decrease overall social welfare because the pie is not as large as it otherwise could have been.\(^9\) As such, placing the risk of loss

\(^7\) See, e.g., Priest, supra note 25, at 1310-12 (explaining how efficient warranty terms depend on the costs to manufacturers of making the product harm resistant, costs to consumers of avoiding harm, and costs to both of different varieties of insurance against harm—and thus the per se rule invaliding warranty waivers effectively undercuts any possible welfare-enhancing variation in these forms of insurance).

\(^8\) See, e.g., Baird, supra note 16, at 940-41.

\(^9\) Indeed, this is a canonical instance of deadweight loss to society arising from a market failure, which may be why courts have often conflated inequitable contract terms with unequal bargaining power. See BORK, supra note 43, at 66, 90-91 (arguing that the primary concern of antitrust law should be with enhancing consumer welfare). Bork’s position so thoroughly infuses the modern law of antitrust that anticompetitive conduct has become almost synonymous with those practices which lead to deadweight loss. However, as we have seen in the contracting context, many terms lead to deadweight loss though they escape antitrust scrutiny. Nonetheless, the rhetoric of contract doctrine concerned with consumer welfare has inherited this unusual relationship with antitrust through the device of “unequal” bargaining power, conjuring images of a monopolist or cartel abusing its market power.
on the cheapest cost avoider is the socially optimal means of distributing primary costs between parties to a contract of adhesion.

2. An Objection to Easy Cases

The cases presented can be objected to on the grounds that they are too easy. But it should not be taken as a sign that the rule cannot be applied to more complex or difficult cases. To this end, consider another frequent term set out in contracts of adhesion: the written option to return a good for a refund or exchange within a certain number of days of purchase. This term seems as if it might place the risk of loss on the party least able to prevent it. After all, once the item has been purchased from the seller and is in the possession of the buyer, the buyer might abuse, misuse, use up, or wear out the item and then attempt to bring it back for a refund or exchange. One might wonder, therefore, if such a term should be unenforceable because it misallocates the distribution of risk between buyers and the sellers, increasing the overall cost of the contract and decreasing the overall contractual surplus across all purchasers.

But this is not necessarily so. A court tasked with analyzing the enforceability of the return option—like a court interpreting many contract disputes under the Uniform Commercial Code (U.C.C.)—would look more broadly than the individual term to the broader return policy itself and the practice of customers and the seller. Given that some number of widgets will be sold with a defect and that therefore the seller will be liable for a breach of contract in those instances, the seller is formalizing an implicit form of insurance that abrogates the need to go to court to enforce a contractual right that many of the purchasers already possess. After all, under the U.C.C., purchasers are already entitled to perfect tender. Because the formal rule requires inspection upon delivery, the real tradeoff in such contracts may be between the cost of requiring that every purchaser inspect every widget purchased at the time of purchase, versus the (presumably) lower cost of allowing purchasers to discover defects through ordinary use while accepting that some number of purchasers will engage in strategic behavior. Moreover, sellers commonly reserve the right not to accept goods they suspect have been broken by the purchaser. Given that it may cost considerably less for the seller to inspect the small number of goods returned by a subset of consumers for intentional misuse rather than require that every consumer inspect every widget at the time it is purchased, it seems eminently reasonable to conclude that a right-to-return term places the burden on the party best able to prevent the

82. See Bebchuk & Posner, supra note 7, at 833.
83. See U.C.C. § 1-205 (2011).
84. See U.C.C. § 2-601 (2011). This provision of the U.C.C. is, coincidentally, itself likely to be an efficient contract default as there are likely to be customers indifferent to the defect and the seller is better positioned to find them than the purchaser.
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loss—the seller—at least where the seller retains the right to reject returns in instances of bad faith.  

B. Minimization of Secondary Costs

While both tort and contract scholars have long understood that placing the risk of loss on the party best able to take precautions against the loss is often optimal as a matter of primary costs, contract scholars have never gone so far as to recommend that courts refuse to enforce terms in contracts of adhesion if they place the risk of loss on the party for whom avoidance is more costly. The oft-cited reasons are what might be termed “secondary costs”—the collection of costs associated with adjudicating and enforcing legal rules along with the loss to society that occurs when parties change their behavior in response to such rules. Yet these scholars have been wrong in their analysis of the secondary costs. Time and again, they have failed to consider that all possible solutions to the problems associated with contracts of adhesion involve secondary costs—including the status quo. The failure to consider that the status quo represents a suboptimal enforcement regime that itself imposes significant secondary costs has meant that scholars have overemphasized the secondary costs of adopting new legal rules even while the status quo continues to impose significant secondary costs of its own.

This section sets out to make the affirmative case that judicial refusal to enforce terms that place the risk of loss on the more costly cost avoider actually minimizes the most salient secondary costs, for four reasons. First, because it minimizes what might be called the “cost of consent”—which is the cost associated with requiring consumers to actually read, understand, and “shop” the contracts they sign. Second, because it minimizes the costs associated with judicially invalidating the wrong terms or enforcing the wrong terms (both of which are pernicious). Third, because, although it demands that courts analyze individual contracts on a case-by-case basis, such a governance regime for contracts of adhesion is likely to be cheaper than the current “fairness” regime, a legislatively imposed “information forcing” regime, or a regime of legislated

85. Another thesis put forward by Professors Scott and Triantis is that each purchaser is willing to pay for the option to return as a means of managing uncertainty about how valuable the item is to him or her individually. This analysis also weighs in favor of generally upholding such terms. Scott & Triantis, supra note 7, at 1474-75. Yet another theory of return policies is reputational—firms engage in return policies as a signal of quality and are therefore willing to accept a financial loss in the contractual surplus in exchange for what they see as a valuable reputational gain. Id. at 1472-73; cf. Bebchuk & Posner, supra note 7, at 833 (arguing that sellers often accept returns even when they do not specify a right to return merchandise in the contract, and that they do not specify the right precisely because some customers would use the term to behave strategically).
86. See Calabresi & Hirschoff, supra note 7.
87. See, e.g., sources cited supra note 5.
88. Cf. Fairfield, supra note 21, at 1422-23 (outlining a version of “cost of consent” that is similar to this one, but more concerned with information costs associated with the tradeoff between negotiating custom contracts and employing standard contracts).
mandatory contract default rules. Fourth, because the rules are *no more likely* to push parties off-contract than other regimes, and also vindicate important social welfare goals *within* contract, the rule is no more likely than other rules to push parties to abandon contract.

1. Minimizing the "Cost of Consent"

Contracts of adhesion exist, in large measure, precisely because they minimize the costs associated with negotiating individual contractual terms. Yet they still impose costs on consumers to the extent that consumers must read, understand, and (if dissatisfied with terms) shop them to other sellers. The goal of designing rules to govern when and whether to invalidate the terms of such contracts must therefore be sensitive to the degree to which even small changes in these costs can have large effects on society's overall welfare. This Subsection, however, argues that invalidating terms that deviate from the optimal terms minimizes the cost of consent.

To see why, it is useful first to imagine what would happen if all terms in contracts of adhesion were enforceable as long as customers signed on the dotted line. It is easy to see that this regime would significantly increase the cost of consent. Buyers would face a significant "market for lemons" problem: at best they would have to trust that the market had ensured that this particular seller, on this occasion, had written an efficient contract. At worst, they would be forced to consult third-parties that could vouch that the terms in the contracts offered by sellers were fair or equitable. Contracting would be a dangerous activity in which purchasers would have strong incentives to read and analyze the fine print in order to ensure that sellers had not snuck unfavorable and opaque terms into the contract. Contracts of adhesion would become an almost entirely reputational contracting regime, which would make entry by new firms more difficult and contract innovation more costly. The entire market could break down because even insurance contracts (to guard against unfavorable contract terms) would themselves need to be read carefully. These factors strongly counsel that to have an efficient market for contracts of adhesion, there must be *some* credible threat that some terms in such contracts will be unenforceable.

If courts must choose a rule for invalidating some terms in contracts of adhesion some of the time, the rule that minimizes the cost of consent will be the rule that allows customers to enter into contracts with sellers with the most confidence that they do not have to read the terms.

89. See Kaplow & Shavell, supra note 7, at 1159 n.461.
91. Radin, Reconsidering Boilerplate, supra note 26, at 650.
92. See infra Subsection II.B.4 for more about the threat of pushing parties "off-contract" imposed by several suboptimal enforcement regimes.
Some scholars have proposed that the current unconscionability doctrines do this job reasonably well—that the best safety-valve is the rule whereby courts invalidate contract terms that are "radically unexpected". The problem with this popular solution is that it essentially unmoors contract doctrine from economics entirely, and to the degree that it does not—by, say, imposing a requirement that courts look to the terms that are ordinarily employed in the relevant market—it is unlikely to invalidate inefficient terms because "uniformity among sellers concerning non-salient terms is the expected result of market pressure whether or not the chosen term is efficient." In other words, the "unfair surprise" and "radically unexpected term" regimes create a paradox—the more commonly firms employ a socially inefficient term the more likely courts will be to uphold them.

More damaging still is that such a rule has at best an ambiguous impact on the cost of consent, and at worst does little to discourage the authors of contracts of adhesion from attempting to write contract terms that place the burden of the loss on the consumer. While the looming threat that courts will invalidate terms that "go too far" may serve to make the market for contracts of adhesion more operable, it still demands that a significant subset of consumers read, understand, and shop the terms in such contracts because not all terms that deviate from the ideal complete contract between buyers and sellers are unenforceable. Consumers cannot read the terms of contracts of adhesion that inefficiently place the risk of loss on them and then leverage their unenforceability as a means of either driving down the price of the contract or convincing the seller to remove the term. Instead, consumers must threaten to procure services from another seller who does not impose the term. Because, however, there are strong incentives for businesses to adopt industry-wide standard terms (so as to reduce, ironically, the cost of consent), this threat is difficult to make, not likely to be credible, and requires that the consumer actually obtain more utility from the competing second-choice product than he loses from the suboptimal contract term.

Their tendency to increase the cost of consent is also why mandatory disclosure rules, information-forcing penalty default rules, and the safe-harbor

93. Barnett, supra note 14, at 637; see Fairfield, supra note 21, at 1447.
94. After all, such an inquiry demands that someone (presumably the judge) determines whether the terms are unfairly surprising. But even if this determination is made—and it is true that the terms are surprising—it is unclear why that, on its own, should make an otherwise efficient and ordinarily desirable term unenforceable. Turning the question around, it is unclear why highly unfair and inefficient terms should be honored merely because consumers know about them.
95. Korobkin, supra note 2, at 1284.
96. See the analogy set out in note 22, supra.
97. Fairfield, supra note 21, at 1441-44 (noting and describing this phenomenon); Hillman & Rachlinski, supra note 3, at 435-37 (same).
98. Schwartz & Wilde, Imperfect Information, supra note 25, at 1457-60 (suggesting that a legislatively mandated disclosure regime and judicial enforcement of all contract terms is superior to a "general ban" on some terms).
given by many courts to firms that do not engage in "procedural" unconscionability are also suboptimal invalidation regimes. If society's goal is to minimize the cost of consenting to contracts of adhesion, its goal should not be to give consumers more information, which only promises that a larger subset of consumers will be required to read, understand, and shop their terms, but rather to maximize consumers' confidence that they do not have to do so.

The rule set forth in this Note, that courts should invalidate welfare-reducing terms, minimizes the cost of consent because it discourages firms from placing the terms in their contracts in the first instance (as they will not be enforced) and because it minimizes search or "shopping" costs since consumers can leverage the unenforceability of the firm's terms directly with the firm without having to find a competitor offering superior terms. As such, this rule, more than the status quo and any rule that has been proposed, actually maximizes the number of consumers who will feel comfortable not reading, understanding, and shopping the terms in contracts of adhesion and thereby minimizes the cost of consent.

The rule can be challenged on the grounds that it will create a free-rider or induced-ignorance problem, however. If consumers become too confident that inefficient terms will not be enforced, they may stop shopping for better terms altogether, and thereby fail to induce firms to write efficient contracts through the market mechanism. In other words, the rule that inefficient terms will be invalidated may have the perverse effect of "crowding out" consumer search—inducing consumers to not shop for favorable contract terms, and thereby creating substantial costs in subsequent adjudication and, by reducing sellers' confidence that their terms will be enforceable, causing them to shift entirely to a "second best" regime.

But this concern seems overblown. As long as litigating unenforceable terms is not costless—for either buyers or sellers—both have incentives to avoid them. Buyers will avoid sellers who place unenforceable terms in their contracts to the extent that the buyer expects to be required to litigate the term—and the cost of litigating an unfavorable term for a consumer that cares about the content of the term is almost sure to outweigh the cost of shopping the term to other firms. On the flip side, sellers also wish to avoid lawsuits to the extent they are costly to defend, and therefore will only write inefficient terms if they believe they can obtain greater benefits from the inefficient term than it costs to have the term litigated and found unenforceable. For such terms to be favorable enough to the seller to be profitable in light of the threat of a lawsuit, one imagines it will have to be so obviously one-sided as to deter customers from contracting with the firm altogether.

99.  Korobkin, supra note 2, at 1254.
100.  See infra Subsection II.B.4 for an explanation of this objection.
2. Minimizing the Cost of False Positives

The problems associated with false-positives are also an oft-mentioned threat to the efficient operation of the market for contracts of adhesion. The theory is that the problem of accidentally invalidating efficient terms—terms that should be enforced—counsels against judicial intervention. The theory is that false positives are in many ways more pernicious than false negatives because, while the market can correct for inefficient contract terms, once a term is invalidated by a court firms can no longer write contracts that include the offending term, even though it is efficient.

But this reflects a misguided status-quo bias. Scholars often ignore that the failure to invalidate truly inefficient terms is far more pernicious in the context of contracts of adhesion than a similar judicial refusal to intervene in the law of antitrust, where incentives to deviate from oligopolistic schemes or enter markets where prices are artificially elevated can be powerful error-correctives. Unlike antitrust, the very point and purpose of writing terms in contracts of adhesion is to grant one party a judicially enforceable right against the other party to the agreement. As such, every instance in which a term is judicially enforced that should not be is as much of a “false positive” as if the term were invalidated. While choosing not to intervene in a situation in which a firm’s conduct is ambiguously anticompetitive does not send a signal to other firms that they may freely engage in the same behavior without threat of reproach, choosing to enforce a provision in a contract of adhesion signals to firms that they should feel confident that they can include and obtain enforcement of the term at issue.

More importantly, an efficient market for contracts of adhesion demands that the judiciary credibly threaten to invalidate at least some contract terms, or else the market for such contracts would grind to a halt. But if courts must invalidate at least some terms, the question then becomes which rule among the rules that might be adopted minimizes false-positives. In that sense, the rule that invalidates terms because they are inefficient on the basis of an inefficient distribution of primary costs—rather than a rule based on “fairness” to the parties, whether entry into the contract was “informed,” or whether the

101. See, e.g., Korobkin, supra note 2, at 1285 (“Judicial determinations of which contract terms are efficient and which terms are inefficient are subject to a high likelihood of error.”); Schwartz & Wilde, Intervening in Markets, supra note 25, at 678; cf. Bebchuk & Posner, supra note 7, at 829 (arguing that these contracts often only appear to offer one-sided terms, but do not in fact); Frank H. Easterbrook, The Limits of Antitrust, 63 TEX. L. REV. 1, 15-17 (1984) (arguing that the risk of false-positives in the antitrust context counsels a hands-off judicial approach).
103. See supra notes 89-92 and accompanying text.
104. See, e.g., Slawson, supra note 2.
market is truly "non-competitive," is the one least likely to lead to the invalidation of otherwise efficient terms. After all, application of these other rules will almost surely lead to the invalidation of efficient terms because they do not primarily concern themselves with rooting out terms on the basis of their inefficiency. If the goal is to minimize false positives, the question is not "what is the right rule?" but rather "what degree of certainty must judges have that the term is inefficient?" The answer to that question depends on several contingent empirical inquiries. Nevertheless, what it reveals is that the rule proposed in this Note, all things being equal, is the proper one.

3. Minimizing Enforcement Costs

Finally, adopting a judicial rule, enforceable by private plaintiffs, that merely substitutes inefficient contract terms for judicially-crafted efficient terms minimizes enforcement costs. Although it demands that courts analyze individual contracts on a case-by-case basis, such a governance regime is likely to be cheaper—as a matter of primary and secondary costs—than the current fairness regime, a penalty-default regime, a legislatively imposed information forcing regime, or a regime of legislated mandatory contract rules.

This is the case for five interrelated reasons. First, by invalidating terms on a case-by-case basis judges may tailor remedies such that the reformed contracts more closely resemble the ideal complete contract that the parties would have mutually preferred. Second, in rendering judgments on the basis of evidence and economic analysis, judges give to sellers writing future contracts the ability to draft in conformity with the judicial rule, thereby reducing the need for future adjudication. Third, by merely invalidating terms or reforming contracts rather than imposing penalty or information-forcing defaults, the rule suggested reduces the cost of consent in future contracts. Fourth, by not penalizing merchants for writing inefficient terms, the regime minimizes the

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106. Schwartz & Wilde, Intervening in Markets, supra note 25, at 668 ("[I]t seems wiser to limit efficiency-motivated interventions to the case of non-competitive markets."). See also David Gilo & Ariel Porat, Viewing Unconscionability Through a Market Lens, 52 WM. & MARY L. REV. 133, 133 (2010) ("We suggest that rather than examining each consumer contract in isolation, courts should inquire whether there is competition, or potential competition, over contracts in the supplier's market.").

107. See Kaplow & Shavell, supra note 7, at 966.

108. Cf. Korobbkin, supra note 2, at 1285 (arguing that judicial determination of which terms are efficient or inefficient is unreliable, and therefore advocating that judges only invalidate inefficient terms if their inefficiency is clear-and-convincingly proven). This argument is addressed in greater depth in Subsection II.B.3, infra.

109. This empirical analysis would need to include the likelihood that judges purporting to apply a particular judicial standard actually apply that standard, see, for example, Bert I. Huang, Lightened Scrutiny, 124 H HARV. L. REV. 1109, 1111 (2011), the degree to which judges commit errors even under a particular decisional standard faithfully applied, see, for example, Alan Devlin & Michael Jacobs, Antitrust Error, 52 WM. & MARY L. REV. 75, 80 (2010), and the degree to which businesses, consumers, and markets will change their behavior as a result of the invalidation or enforcement of an inefficient term. See infra Subsection II.B.4 for a discussion of the most difficult challenge this problem poses for any decisional paradigm.
threat of driving sellers to abandon contract as a means of vindicating their aims.\textsuperscript{110} Fifth, and most importantly, adjudicating the efficiency of terms in contracts of adhesion is actually well-within judicial ken because they are not the product of a bargain between the parties and are therefore far more tort-like and susceptible to intelligent judicial appraisal than ordinary negotiated contracts.\textsuperscript{111}

To understand why a system of judicially-crafted efficient (rather than penalty) defaults is superior to alternatives, it is useful first to consider one frequent method by which contracts are invalidated: judicial determinations of unfair surprise, unreasonableness, and unfairness.\textsuperscript{112} The problems with this regime include more than its greater tendency to produce false positives than an efficiency approach.\textsuperscript{113} It often lends no intelligible principles by which future contract drafters can hope to adapt their contracts of adhesion so as to avoid future invalidation.\textsuperscript{114} This is because the currently endorsed principles invalidating contracts are \textit{relational}—in deciding whether a contract is unconscionable these rules consider the relative bargaining positions of the individual parties to the suit—the specific buyer and seller—rather than the interests of the class of customers as a whole.\textsuperscript{115} It is also because the considerations on which courts rely often relate not to the effect of the term on the division of the contractual surplus at issue in the case at hand, but on the relative positions of the parties in the marketplace—focusing on such factors as “one-sidedness” and “unequal bargaining power.”\textsuperscript{116} Remarkably, some scholars even argue that obviously welfare-reducing terms should be upheld if

\begin{itemize}
  \item \textsuperscript{110} See infra Subsection II.B.4 for a description of this phenomenon.
  \item \textsuperscript{111} Cf. Jody S. Kraus & Robert E. Scott, \textit{Contract Design and the Structure of Contractual Intent}, 84 N.Y.U. L. Rev. 1023, 1052 (2009) (arguing that parties negotiate and design agreements in reliance on expectations about how courts will construe them, counseling against judicial deviation from formalistic interpretive principles if one believes that it is welfare maximizing to vindicate the \textit{specific} intent—rather than contractual objectives or aims—of the parties).
  \item \textsuperscript{112} Gilo & Porat, supra note 106, at 137 (“The question of whether to strike down such a clause is generally determined by courts according to a combination of three considerations, mostly under the doctrine of unconscionability: first, the information gap between the supplier and his consumers, which exists when consumers are not aware of the full-value loss the clause entails; second, whether the supplier enjoys superior bargaining power; third, the degree of harshness, or one-sidedness, of the clause.”); Hillman & Rachlinski, supra note 3, at 456 (“Thus, the limited role of the courts in policing standard terms has been to bar only those terms that offend public norms. The courts have developed legal doctrines that curb form abuse largely from three sources: the unconscionability doctrine, the \textit{Restatement (Second) of Contracts} section 211(3), and the doctrine of reasonable expectations.”).
  \item \textsuperscript{113} See supra Subsection II.B.2.
  \item \textsuperscript{114} See Kaplow & Shavell, supra note 7, at 1161.
  \item \textsuperscript{115} See Baird, supra note 16, at 944-46 (criticizing the decision in Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965), on similar grounds).
  \item \textsuperscript{116} Gilo & Porat, supra note 106, at 137 (noting that “information gap[s],” “harshness,” “one-sidedness,” and “superior bargaining power” are all common factors in modern judicial analyses of unconscionability).
\end{itemize}
courts find the markets in which the firms are writing contracts to be essentially competitive because then the terms are likely to be desired.\textsuperscript{117}

Another approach has been one of "information forcing"—designed, as the name suggests, either to force merchants to reveal the one-sided terms in their contracts to consumers,\textsuperscript{118} penalize them for hiding such terms,\textsuperscript{119} or require that they prophylactically disclose material facts about the quality and condition of their products and services as a means of improving the degree to which consumers are informed.\textsuperscript{120} The problem with all of these approaches is that they increase the costs of consent because they all depend on requiring consumers who would otherwise be rationally uninformed about the boilerplate terms in the contracts that they sign to read, understand, and assent to them even if they are indifferent to the unfavorable terms. This elevates costs for all services and goods, even those rendered by honest sellers,\textsuperscript{121} and across the board for all consumers, in terms of both time and cognitive resources invested in entering into contracts—all so that what might be a small number of consumers are protected from unscrupulous inefficient contract terms. Information, it seems, is often put forward as a cure because it does not entail disruption of the fundamental market mechanism, and allows us to move closer to a market with "perfect" information. But this does not logically mean that it should be the solution that we favor. There are strong reasons to think that minimizing the need to read and understand the terms in contracts of adhesion should be a central goal as long as the terms can be made to be efficient as well.\textsuperscript{122}

Mandatory contract default rules—wherein the State or an agency impose form terms on every merchant transaction—have long been recognized as suboptimal because they do not grant flexibility to design innovative

\textsuperscript{117} Schwartz & Wilde, \textit{Intervening in Markets}, supra note 25, at 668 (arguing that efficiency-motivated interventions should be limited to non-competitive markets). \textit{See also} Gilo & Porat, \textit{supra} note 106, at, 133 ("We suggest that rather than examining each consumer contract in isolation, courts should inquire whether there is competition, or potential competition, over contracts in the supplier's market."). Part I, \textit{supra}, argues that the overriding concern with discovering whether markets can police inefficient terms that seems to drive scholars toward this approach is fundamentally misguided.


\textsuperscript{119} \textit{See} Korobkin, \textit{supra} note 2, at 1288-89 (arguing for limiting enforcement of unconscionable contracts "to deter other sellers from similar bad faith or carelessness").

\textsuperscript{120} \textit{See} Schwartz & Wilde, \textit{Intervening in Markets}, \textit{supra} note 25, at 668 (advocating such an approach in non-competitive markets).

\textsuperscript{121} Mandating prophylactic disclosure entails significant costs, including the cost to maintain and run an agency or institutional regulator, the cost to police the disclosures, and the cost to firms of producing the information. \textit{See}, e.g., Samuel Issacharoff & George Loewenstein, \textit{Unintended Consequences of Mandatory Disclosure}, 73 TEX. L. REV. 753, 785-86 (1995) (making these points in the analogous context of mandatory disclosures under the Federal Rules of Civil Procedure).

\textsuperscript{122} \textit{See} supra Subsection II.B.1.

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contracts. One must concede, however, that such rules are cheap to enforce: all judges are required to determine is whether the contracts conform to the mandatory rules. But it is easy to see that mandatory rules are not likely to be well-tailored to the thousands of different possible products and services markets to which they might be required to apply. As such, mandatory rules would almost surely demand that courts enforce inefficient, welfare-reducing terms simply because those terms are required by the state. This inability to tailor means that while the direct costs of enforcement are low, overall social welfare is almost sure to be diminished just as a matter of primary contract costs.

What is more, increasing the cost of entering into contracts of adhesion across the board—by requiring greater information disclosure or conformance with state mandated default rules—will also have the perverse effect of causing firms to substitute other means in the place of contract, a result that could reduce social welfare.

Judicial invalidation of inefficient contract terms, on the other hand, preserves the market’s balance of information-costs because it neither penalizes sellers for including the terms in the contracts, nor requires consumers that arerationally ignorant of the terms in the contracts that they sign to become informed even though they plan to sign the contract anyway. Rather, if consumers have confidence that such terms are invalid, those that care are more likely to attempt to negotiate the terms with the seller (to reduce the costs associated with a lawsuit to invalidate the term), and those that do not care will not feel as if they must read the contracts carefully because they can be confident that if the terms are inefficient they will be invalidated at a later date. All of this reduces the cost of consent.

Most importantly, contrary to contemporary scholarly consensus, judges would seem to be eminently capable of policing inefficient terms in contracts of adhesion. Scholars have repeatedly asserted, often at the outset of their Articles, without evidence, and before proceeding to discuss their superior suggested

123. See, e.g., Schwartz & Wilde, Imperfect Information, supra note 25, at 1456-59.
124. For a description of primary costs, see supra note 44.
125. See infra Subsection II.B.4.
126. An approach advocated by Korobkin, supra note 2, at 1289, in order to deter sellers from placing sub-optimal terms in the contracts that consumers will believe are enforceable. This seems like the wrong approach. While sellers may be tempted to place terms that skirt the edge of enforceability, it is not clear why Korobkin believes they must be penalized for placing sub-optimal terms in their contracts in order to prevent them from including them—after all, it only takes a single lawsuit to invalidate the term. If not even one consumer brings a claim, it would seem to me the one-sidedness of the term would be open to question.
127. An approach advocated by Schwartz & Wilde, Intervening in Markets, supra note 25, at 635, who take the roundabout approach of hypothesizing that if consent is what we want, then giving consumers more information is the best approach to ensuring consent. Because consent is not necessarily what we want, Schwartz & Wilde’s proposal rests on vulnerable premises. Yet, their solution is unfortunately often repeated without the caveat limiting its scope. See, e.g., Hillman & Rachlinski, supra note 3, at 442.
alternatives, that courts "have difficulty distinguishing between terms that create a reasonable arrangement of risks and terms that constitute exploitation of consumers," and that "requiring courts to determine de novo whether particular terms are efficient or inefficient would strain the bounds of judicial competence and invite a high error rate." And this incompetence, they argue, would create "tremendous uncertainty" that would make it hard for drafters of contracts of adhesion to be confident in the enforceability of their contracts going forward.

To the extent that reasons are given for this lack of faith in the judiciary, three seem most salient. First, and most powerfully, judges are prone to focusing on ruling on the case before them and not on the aggregate policy at stake for all parties to the contract. Second, contractual efficiency is a contingent empirical question, and courts simply do not have the facts and cannot gather them. Third, judges are not well suited to deciding cases involving businesses and their customers because they lack the relevant business experience.

The third of the aforementioned arguments seems easy enough to overcome. Judges do not have to be criminals to understand how criminals are likely to behave. Generalist judges are called upon to decide highly fact-bound and complex antitrust cases that often result in treble judgments that can run into the billions of dollars, even though judges are not economists. Yet, at the same time, these scholars argue we should not trust them to determine whether a mandatory arbitration clause in a form consumer contract is efficient or not. The judicial system is founded on an expectation that judges are capable of reading, absorbing, and understanding enough to make the right decision, even in complicated cases. If this is partly a myth, it is a myth upon which the justice system constantly relies and it has for the most part operated quite well. The judiciary’s appellate process preserves a robust system of institutional error correction. Judges seem capable of grasping elementary psychology and


130. Korobkin, supra note 2, at 1253 (citing, inter alia, Llewellyn, supra note 128, at 704).

131. Id.

132. There are others. See Schwartz & Wilde, Imperfect Information, supra note 25, at 1458-59 (arguing that firms are so unlikely to write contracts with inefficient terms that judicial intervention will simply do more harm than good).

133. See, e.g., Hillman & Rachlinski, supra note 3, at 441 & n.65.

134. See, e.g., Schwartz & Wilde, Intervening in Markets, supra note 25, at 678-82.

135. See, e.g., Hillman & Rachlinski, supra note 3, at 441.
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economic theory,\textsuperscript{136} which is enough to successfully determine whether contract terms are efficient or inefficient given awareness of all the facts.

That judges cannot obtain the relevant facts seems to underlie the second objection. Those who take this view argue that courts and litigants simply cannot reliably know why a term was placed in a contract of adhesion, and even if they could, cannot determine ex post whether that decision was efficient ex ante.\textsuperscript{137} But this argument becomes weaker when one considers contracts of adhesion. In an ordinary contract case there could be some question as to why a particular term was placed in the contract—perhaps each party had a different understanding of the purpose the provision was meant to serve. But such problems do not arise in contracts of adhesion cases. Because contracts of adhesion are "take-it-or-leave-it" propositions, it is the seller who placed the term in the contract, and therefore courts should expect that the seller can provide the court an economic justification for drafting the term it did. But if we expect that sellers can provide such economic justifications, then it seems difficult to argue that courts cannot understand and assess both the credibility and economic rationality of the arguments made to them.

The foregoing justifications would seem sufficient in themselves to overcome the final objection that courts are prone to focusing on ruling on the case before them rather than on the aggregate policy implications of their decisions. After all, as their record in antitrust cases reveals, judges are extraordinarily aware of and sensitive to the implications of their decisions on other future cases.\textsuperscript{138} Indeed, that is why they write precedent-setting opinions, so that they may be held to the principles upon which they decided the prior case.\textsuperscript{139} Far from breeding "uncertainty," the judiciary's very fidelity to principled decision-making makes the law more certain and easier to understand and apply.\textsuperscript{140}

Even more, however, it would seem that weighing whether the terms in contracts of adhesion are efficient or inefficient would be almost perfectly

\textsuperscript{136} See BORK, supra note 43, at 277 ("[C]orrect antitrust rules require only basic economics and ... are capable of easy and precise application by courts"); id. at 8 ("[T]he tenets of basic economics can be made] clear both to the lawyer unfamiliar with economics and to the economist innocent of law, as well as to those ... who have previously escaped formal involvement in either field."); Michael R. Baye & Joshua D. Wright, \textit{Is Antitrust Too Complicated for Generalist Judges? The Impact of Economic Complexity and Judicial Training on Appeals}, 54 J.L. & ECON. 1, 20 (2011); Richard A. Epstein, \textit{The Perilous Position of the Rule of Law and the Administrative State}, 36 HARV. J.L. & PUB. POL'Y 5, 8 (2013).

\textsuperscript{137} See, e.g., Korobkin, supra note 2, at 1284-85.

\textsuperscript{138} See, e.g., BENJAMIN N. CARDOZO, \textit{THE NATURE OF THE JUDICIAL PROCESS} 149 (1921) (arguing that for several reasons "adherence to precedent should be the rule and not the exception").

\textsuperscript{139} See, e.g., William Blumenthal, \textit{Introductory Note}, 65 ANTITRUST L.J. 813, 820 (1997) ("[J]udicial decisions have the attributes of a public good.").

\textsuperscript{140} See, e.g., Timothy J. Muris, \textit{Economics and Consumer Protection}, 60 ANTITRUST L.J. 103, 104 (1991) ("Litigation produces not just a resolution of the dispute before the court—which is what the parties are primarily, if not exclusively, interested in—but it also often produces a precedent to guide others, usually in the form of a written opinion. Many can obtain the benefit of that precedent for their legal planning without paying for it.").

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analogous to judging in tort cases, an area in which law and economics has had its most profound impact. Torts calls upon judges to take account of myriad social facts in deciding which party (as a class) is better positioned to take optimal precautions against an accident, a determination most famously set out by Judge Learned Hand in United States v. Carroll Towing Co. where he held that negligence is the failure to take cost-justified precautions. In contracts of adhesion, rather than looking at society as a whole and the generalized interactions of those in it, courts are tasked with looking at the incentive structure for the class of participants on each side of a contract created by its terms. Moreover, as this Note has argued, the approach to determining the welfare-maximizing liabilities developed for tort law can be imported to the law of contracts of adhesion to the extent that the law of contracts of adhesion is analogous to torts.

Contracts of adhesion and torts are very similar. In both instances, unlike negotiated contracts, the parties have not bargained over the specific terms of their relationship. In both instances, the optimal judicial rule will be the one that makes their interactions efficient ex ante rather than fair ex post. In both instances the relevant facts are unlikely to be obscure and the specific contours of their interaction are not likely to be complex, because in such cases it would be cost-justified for them to negotiate a particular arrangement rather than settle for the defaults (here, the defaults set out in the contract of adhesion).

In other words, the longstanding arguments that judges are unlikely to be able to determine the efficiency of terms in contracts of adhesion has served as a convenient reason to sidestep the issue, rather than engage with the substantive analysis necessary to determine which terms judges should invalidate. In fact, judges are likely to be eminently capable of deciding whether the terms in such contracts are inefficient and capable of invalidating them with clarity, predictability, and minimal disruption to the legal system. Scholars and courts have, it seems, sought to avoid inelegant and complex factual inquiries into the efficiency of the terms of contracts of adhesion in favor of market solutions predicated on the provision of greater information and consumer choice, when, in fact, such judicial inquiries are likely to be a more efficient means of invalidating inefficient terms.

141. 159 F.2d 169, 173 (2d Cir. 1947).
142. See Radin, Reconsidering Boilerplate, supra note 26, at 619, 642-46.
145. See, e.g., Hillman & Rachlinski, supra note 3, at 441.

One of the most powerful and underappreciated problems with making any change to legal rules occurs when such changes induce parties to leave the regime entirely. This Note terms this phenomenon going “off-contract” because the parties are no longer using the law of contract to vindicate whatever interests they have. The argument is that “where the conditions for optimality cannot be fully satisfied, correction of the flaws in only some of the conditions will not necessarily lead to an improved outcome.” If, therefore, the law of contract becomes too costly, parties may simply stop writing contracts and shift to a system of trading on unenforceable reputational norms or choose to embed what would have been inefficient contract terms into the products themselves (by making, say, a piece of software one would have been contractually barred from copying break if copied). If this happens, it may be the case that an otherwise optimal rule for invalidating terms in contracts of adhesion has actually made everyone worse off. Even though the terms inside the domain of contract law are optimal, sellers will resort to a domain less optimal than contract law to avoid them because contracting as a vehicle for engaging in market transactions is too costly to vindicate their goals. The set of rules governing the invalidation of contract terms has pushed them “off-contract.”

147. Id.
148. See Bebchuk & Posner, supra note 7, at 828 (arguing that legally imposed “balanced” contracts could impose costs on sellers and buyers alike that are ordinarily controlled by sellers’ reputational concerns).
150. See Baird, supra note 16, at 937 (“There is no way to answer this question with certainty, but the risk of advantage-taking with respect to boilerplate seems less than with respect to other hidden attributes. One can cheat buyers by exploiting their ignorance of a product attribute, but everything suggests that an unscrupulous seller is likely to gain more from hidden attributes other than boilerplate. Sellers inclined to mischief will direct their attention to the places where the potential gains are the largest and the costs smallest. By this standard, fine print is an exceedingly poor candidate for would-be advantage-takers.”).
151. There is a hidden normative claim in all this—namely that there is such a thing as a “domain” of contract law. Schwartz and Scott have attempted to bridge this gap, arguing that “contract law should facilitate the efforts of contracting parties to maximize the joint gains (the ‘contractual surplus’) from transactions” and that “the state should choose the rules that regulate commercial transactions according to the criterion of welfare maximization.” Alan Schwartz & Robert E. Scott, Contract Theory and the Limits of Contract Law, 113 YALE L.J. 541, 544 (2003). In theory, this may mean that if parties want to employ extralegal norms rather than enforceable terms, courts should vindicate that interest.
152. One might think the move away from courts to mandatory arbitration is a manifestation of the phenomenon of going “off-contract.” See, e.g., Kenneth S. Abraham & J.W. Montgomery, III, The Lawlessness of Arbitration, 9 CONN. INS. L.J. 355 (2003); Knapp, supra note 118.
This objection is powerful for two reasons. First, it embodies a real phenomenon that scholars have recognized may already be at work—namely, the shift away from contract to reputation and the shift away from written terms to “embedded” terms (where the product or service itself is structured in such a way as to vindicate what would have otherwise been a written term). Second, it raises deep questions about the utility (and even the ability) of contract rules to structure social relationships. If sellers can simply opt-in to the law of contract when it suits them, and opt-out otherwise, it is unclear if any legal regime can govern market transactions in a manner capable of enhancing the overall social welfare of consumers.153

Bebchuk and Posner have argued that reputational norms are far more constraining than the enforceable law of contract, and therefore, courts should enforce even harsh, one-sided and seemingly inefficient terms precisely because sellers enforce them at the risk of their own reputations.154 In such a world, consumers could in fact exploit a contract regime of “balanced” terms to their advantage—using, for instance, a written promise to accept returned merchandise for a refund as an opportunity to return goods that they have intentionally misused. Better, in their view, to allow the seller to omit the term but then accept returns at its own discretion without granting consumers an enforceable right of return.155 Their model can easily be extended and used to justify an enforce-in-every-case contract regime, wherein courts and judges simply accept that the reputation-market will regulate merchant conduct and terms will not be enforced if they damage a firm’s good will or reputation.156

From a completely different angle, Baird has described, and Radin has suggested, that firms can easily substitute physical changes to products or services to achieve the same ends they might have through written terms in contracts of adhesion.157 Baird argues that this makes much of the debate about whether terms in form consumer contracts are efficient or inefficient pointless, as whatever enforcement regime the courts choose, sellers will work around it by “building” the terms into their physical products or services.158 Radin has argued that such a regime shows there is no normative distinction between the law of products liability and contracts where such substitutions can be made—because making it physically impossible to copy software (for example) is analogous to a rule that one may not copy it.159

The issue these alternatives to contract raise is whether refusing to enforce terms that place the risk of loss on the costlier cost avoider will push parties

153. See Williams, supra note 146, at 934.
155. Id. at 833.
156. Id. at 834.
157. See Baird, supra note 16, at 939; Baird, supra note 149, at 2720-22; Radin, Reconsidering Boilerplate, supra note 26, at 645-46.
159. Radin, Reconsidering Boilerplate, supra note 26, at 645-46.
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off-contract, reducing consumer welfare overall. For instance, sellers might now spend more to circumvent the judicial invalidation of the inefficient terms than is saved by preventing them from drafting them. Or sellers might be unable to offer contracts that are as welfare enhancing as they once did because consumers will exploit the “balanced” terms they are required to write.

One answer to this question is analogous to the answer given to the rejoinder that inefficient terms come at a discount—even if the inefficient terms mean the price is discounted, there is no reason to believe that the inefficient term is perfectly counterbalanced by the discount. Invalidating inefficient terms may mean that sellers will substitute the inefficient term by chiseling on product quality. But it may not be the case that the two are perfect substitutes, and there is good reason to believe that it is easier to hide inefficient terms in fine print than to hide corner-cutting on products and services themselves.

Perhaps a better answer is that courts can take into account the possibility of parties going off-contract when ruling on the efficiency or inefficiency of contract terms. Indeed, if firms fear that consumers will exploit balanced terms, it is unclear why they cannot write contracts that bring to the courts’ attention their concern with this possibility. One could imagine that a firm under the Bechuk and Posner model would seek to waive strict liability for all injuries, but then would compensate those customers who were injured when it was truly a result of product defect and not customer negligence or malfeasance in order to preserve the firm’s reputation. But if the firm can articulate welfare-enhancing reasons for drafting a term that on its face appears unfair or inefficient, why not simply demand that the firm explain the reason for the term? It is unclear why this would not be preferable to hanging the Sword of Damocles (in the form of the drafters’ unilateral right to exercise its harsh or one-sided contract terms) over every contract of adhesion into which consumers might enter. If firms want their contracts enforceable only when customers engage in strategic behavior, it is unclear why they cannot write the contract in precisely this way.

The phenomenon of circumventing invalidated terms by embedding the terms in the product itself poses a more difficult problem because it may very well be welfare-reducing to drive firms to engage in such workarounds. Yet, perhaps ironically, the very terms that are most likely to be embedded in the product if invalidated are terms that are likely to be salient to customers, subject to market competition, and therefore efficient. Thus, if courts analyze a term that could be built into the product itself, the likelihood is that the term will be one that was written in, rather than built in, for a reason.

There is no perfect solution to the phenomenon of driving parties off-contract, and it is hard to say that any particular rule for invalidating contracts

of adhesion will optimally prevent parties from going off-contract. This is a pervasive problem with analyses of the second-best alternative in any legal regime.\textsuperscript{161} Perhaps the best that can be said is that as it pertains to some of the most important terms consumers seek to invalidate—mandatory arbitration clauses, forum selection clauses, and strict liability waivers—it is unclear how the seller could circumvent the clause by shifting to a second-best alternative and therefore the threat is nebulous.

III. Conclusion

While it may appear that the rule this Note proposes will result in courts invalidating more terms in contracts of adhesion, the opposite is more likely to be true. The purpose of this Note is not to advocate that courts invalidate more or fewer terms in contracts of adhesion, but that they invalidate the right terms. The conclusion this Note draws is that courts should sometimes invalidate terms in contracts of adhesion, if the terms reduce overall consumer welfare, and that the terms that reduce consumer welfare are those that place the risk of loss on the costlier cost-avoider or that grant an option to one of the parties to impose non-reciprocal costs on the other.

\textsuperscript{161} See Williams, supra note 146, at 934.