Consumer Contract Exchanges and the Problem of Adhesion

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Businesses and sophisticated parties have long used “contract exchanges,” like the Chicago Board of Trade, to obtain a fair price and protect themselves from market volatility. These contract exchanges have greatly benefited both their participants and the public at large, but participation was long limited to a wealthy few. A decade ago, however, Internet websites, including Hotwire and Priceline, brought the power of contract exchanges directly to consumers, allowing regular people to flex their collective bargaining power to obtain low prices on travel services. Even more recently, other such “consumer contract exchanges,” including Prosper and MoneyAisle, have organized vibrant markets for small loans and certificates of deposit to the benefit of consumer borrowers and investors.

Modern contract law usually bends over backwards to protect consumers, so one would surely expect it to be supportive of, or at least not hostile to, these developments. Surprisingly, however, one strand of common law doctrine—the rules that pertain to so-called “contracts of adhesion”—actually stifles the development of consumer contract exchanges by undermining the reliable enforceability of the contracts they generate. Courts should therefore clarify that while exchange-traded consumer contracts fit the formal definition of contracts of adhesion, they should be enforced as if they were ordinary, negotiated agreements.

This Article makes four novel contributions. First, it defines contract exchanges and enumerates their necessary institutional attributes. Second, it theorizes and recognizes a new form of contract exchange—the consumer contract exchange. Third, it suggests that the doctrine of adhesion hinders the further development of consumer contract exchanges. And fourth, it offers a common law solution to this common law problem.

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Introduction

For more than a century, business interests have used “contract exchanges” like the Chicago Board of Trade (“CBOT”) to obtain a fair price and protect themselves from market volatility. A decade ago, websites like Hotwire and Priceline brought this concept to consumers, thereby allowing regular people to flex their collective bargaining power to get lower prices on travel services. And in just the past few years, other consumer contract exchanges have sprung up, such as Prosper, where consumers seeking small loans can find other consumers that want to lend money. But one aspect of modern contract doctrine—namely the special rules that pertain to “contracts of adhesion”—prevents these innovative consumer contract exchanges from reaching anything close to their full potential. This Article explores this unintended consequence of the adhesion doctrine and proposes a resolution.
Consumer Contract Exchanges

This Article defines contract exchange as an organized market where contracts are created and traded among strangers. Two institutional attributes serve as prerequisites to all functioning contract exchanges: first, nonnegotiable standard form contracts must be used, such that every contract is fungible with every other; second, those contracts must be reliably enforceable at law. Contract exchanges confer substantial benefits on participants, including enhanced liquidity and reduced transaction costs. Contract exchanges also benefit the public at large through price discovery—the public revelation of transaction price information.

To have an organized market in, say, West Texas sour crude oil, every barrel must be substantially identical to every other, because the market would not function if the type or quality of the oil varied. The same is true for a contract exchange. Thus, the first prerequisite of a functioning contract exchange is that the contracts created or traded must be fungible. In other words, they must be standardized and nonnegotiable, and they must concern a generic subject matter. And while trust or informal means of enforcement might suffice when dealing with known counterparties, trading on an exchange is anonymous. Thus, the second prerequisite is that the contracts must be reliably enforceable at law.

Traditional contract exchanges, such as a commodities futures exchange, are exclusive private organizations. CBOT, for instance, has only a few thousand “seats,” each of which sells for millions of dollars to those who can afford one. The result is that a wealthy few reap the benefits of participating in a contract exchange—but ordinary consumers do not. This may have been inevitable when the number of traders was limited by the size of an exchange hall. But the arrival of the digital era has rendered physical constraints irrelevant. The Internet makes it possible to organize a contract exchange with an unlimited number of seats—and that is precisely what has happened. A new form of contract exchange has recently emerged, one in which consumers are expressly invited to participate. This Article calls these “consumer contract exchanges” and they display both of the necessary institutional attributes of all functioning contract exchanges.

Several examples will be considered below, including Hotwire and Priceline, websites where consumers can contract for generic travel services, and Prosper, a “peer-to-peer” debt market where consumers can make unsecured loans to one another. Just as CBOT was a boon for farmers and others, these new consumer contract exchanges serve consumers well. Empirical data show that consumers receive better prices and interest rates—and suffer less racial, gender, or other discrimination—when they participate in consumer contract exchanges. In short, consumer contract exchanges are good for consumers and in the public interest.
But that old "brooding omnipresence in the sky"—the common law—casts a dark shadow that has stunted the development of consumer contract exchanges. As a matter of contract doctrine, a nonnegotiable standard form consumer contract is viewed as a "contract of adhesion," and its terms are subject to a substantive judicial review for fairness. This substantive review has the effect of undermining the reliable enforceability of contracts of adhesion. But as just explained, for a contract exchange to function, the contracts must be reliably enforceable.

This paradox has been long understood in the context of traditional contract exchanges like CBOT. In those cases, courts have appreciated that contracts of adhesion are necessary to the functioning of the exchange and, accordingly, have held that even though the contracts traded meet the definition of contracts of adhesion, they should not be subject to the fairness review. In contrast, no court has addressed the issue in the context of a consumer contract exchange. And judicial concerns over contracts of adhesion are heightened when the "adherent" is a consumer. It is, therefore, unclear at present whether courts can be counted on to reliably enforce the contracts of adhesion originated or traded on consumer contract exchanges. Hotwire and Priceline have worked around the problem by requiring full payment upfront, but this solution can only work for small value transactions. For contracts of any significant size, there is no substitute for reliable enforceability.

This uncertain legal enforceability reveals a crack in the legal infrastructure of consumer contract exchanges—one that needs immediate repair. This Article argues that contracts created or traded on consumer contract exchanges should be treated by courts as if they were ordinary, negotiated agreements. Standardization of terms should not be viewed with suspicion but rather as an indication of a well-functioning marketplace. In short, even though exchange-traded or -created consumer contracts meet the formal definition of a contract of adhesion, they should be treated as if they do not.

This Article makes four primary contributions to the literature. First, it defines contract exchanges and enumerates their necessary and useful institutional attributes. Second, it theorizes a new form of contract exchange called a consumer contract exchange and offers several contemporary examples. Third, it shows that the common law contract doctrine of adhesion hinders the development of consumer contract exchanges. And fourth, it suggests a common law solution to this problem.

This Article proceeds in three parts. Part I defines the term "contract exchange," describes the many benefits and few costs of such exchanges, and describes several contract exchanges oriented toward consumers. Part II explains the concept of a contract of adhesion and describes current common

3. See infra text accompanying notes 211-216.
law doctrine on adhesive contracts. Part III builds on the previous Parts to argue that the uncertain legal enforceability of contracts of adhesion hinders the growth and development of consumer contract exchanges. To solve this problem, this Article proposes that the law should treat contracts created or traded on consumer contract exchanges the same as ordinary, nonadhesive contracts.

I. Contract Exchanges

A. Definition

This Article defines a “contract exchange” as a centralized and organized marketplace for the origination or trading of specific contracts. A contract exchange is similar to any other marketplace, from a stock exchange to a flea market, in that it brings buyers and sellers together in a single location. It differs in that contracts for goods or services—not goods or services themselves—are traded. A familiar example is a futures exchange, like CBOT, where contracts for the future delivery (that is, futures contracts) of corn, wheat, and other crops have been traded since the nineteenth century.4 By way of contrast, municipal and corporate bonds (that is, lending contracts) are bought and sold in private one-off transactions, usually over the telephone, rather than traded on contract exchanges.5

The concept of a contract exchange may seem a bit abstract—and indeed it is. One cannot walk into a futures exchange and buy wheat; one can only buy a contract that entitles one to receive wheat for a given price at a given time in the future.6 Immediate trades, such as goods for money, are not transacted on a contract exchange but rather on the so-called “spot” or “cash” market.7 Thus, a

4. See Jonathan Lure, The Chicago Board of Trade 1859-1905, at 22-23 (1979); George F. Stone, Board of Trade of the City of Chicago, 38 ANNALS AM. ACAD. POL. & SOC. SCI. 189, 191 (1911). Futures exchanges, featuring lively “trading pits” of gesticulating traders, have become an enduring part of American popular culture. See, e.g., Ferris Bueller’s Day Off (Paramount Pictures 1986) (depicting suburban Chicago high school students who skip school to have a perfect day in Chicago by, among other things, paying a visit to CBOT); Trading Places (Paramount Pictures 1983) (showing comedic plot that centers around frozen concentrated orange juice futures contracts).


7. Roberta Romano, A Thumbnail Sketch of Derivative Securities and Their Regulation, 55 Md. L. REV. 1, 7 (1996) (noting that in the “spot” or “cash” market, “goods or services purchased or sold are immediately transferred and paid for”). Note that these cash transactions are not contracts,
market in wheat contracts is “derivative” of wheat itself, and exchange-traded contracts are often called “derivatives.”

Contract exchanges have rules, of one form or another, that both define the terms of the contracts traded and govern trading. These rules are designed to guarantee uniformity of the contracts, as well as the underlying subject matter of the contract. Thus, from a buyer’s perspective, any contract for wheat on the exchange contains identical contractual terms and concerns identical quantities and qualities of wheat. This uniformity is essential to the functioning of the contract exchange. Off the exchange, of course, private parties are free to make whatever deals they desire. But on the exchange, only certain specific contracts may be consummated. That is to say, exchange participants are only allowed to enter into one of a handful of form contracts whose every term—save the price—is specified by exchange rules and may not be altered.

A contract exchange may offer either a “primary market” or a “secondary market”—or both. In a primary market, two exchange participants mutually assent to one of the authorized form contracts at a price agreeable to both. Once a contract is created in a primary market, one party may wish to sell their rights under the contract to a third party. Such a sale is called a “secondary sale,” and the market for such trades is called a secondary market. Secondary markets are made possible by a common law rule that allows contract holders to freely assign their contractual rights in the absence of an agreement to the contrary.

Contract exchanges are socially beneficial organizations that serve the public interest as well as the interests of private participants. As discussed more

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8. Romano, supra note 7, at 2 (explaining that derivatives are “financial instruments whose value derives from some other, more fundamental, asset”); see KOLB & OVERDAHL, supra note 5, at 56.
10. See CBOT RULEBOOK, supra note 9, § 14101 (“Each futures contract shall be for 5,000 bushels of No. 2 Soft Red Winter, No. 2 Hard Red Winter, No. 2 Dark Northern Spring, and No. 2 Northern Spring at par; and No. 1 Soft Red Winter, No. 1 Hard Red Winter, No. 1 Dark Northern Spring and No. 1 Northern Spring at 3 cents per bushel over contract price. Every delivery of wheat may be made up of the authorized grades for shipment from eligible regular facilities provided that no lot delivered shall contain less than 5,000 bushels of any one grade in any one facility.”); id. § 14104 (defining and describing wheat grades).
11. 3 FARNSWORTH, supra note 7, § 11.2, at 66; see Shannon D. Kung, The Reverse Triangular Merger Loophole and Enforcing Anti-Assignment Clauses, 103 NW. U. L. REV. 1037, 1043 nn.31 & 33 (2009) (collecting authorities). Note that “assignment” refers to the transfer of a contractual right, which is generally allowed, and which extinguishes the original obligee’s right. “Delegation,” or the transfer of a contractual duty, is also generally allowed, but it does not extinguish the original obligor’s duty (although the delegee’s performance will have that effect). 3 FARNSWORTH, supra note 7, § 11.10, at 125, 127.
fully later in this Section, contract exchanges facilitate efficient anonymous transactions among strangers by reducing transaction costs and counterparty risk. In addition to these private benefits, contract exchanges also provide important public benefits, most notably through the process of price discovery.\textsuperscript{12}

Two institutional attributes serve as prerequisites to the existence of a working contract exchange. First, because the primary purpose of a contract exchange is to create a liquid market in fungible assets, nonnegotiable, standard form contracts are required. Second, because in a contract market one contracts with anonymous strangers, the contracts must be reliably enforceable at law. In addition to these prerequisites, there are several other institutional attributes of contract exchanges that are not strictly necessary but are nonetheless important to the smooth functioning of such exchanges. These include a clearinghouse, margin requirements, membership standards, and public price disclosure, all of which are regularly found in current contract exchanges.

The remainder of this Part describes the nature and importance of all of these institutional characteristics, using the traditional commodity futures exchange as an exemplar.\textsuperscript{13} This Part then concludes with a normative discussion of the social benefits and costs of contract exchanges.

1. Necessary Institutional Attributes

The two institutional attributes that serve as prerequisites to the existence of a functioning contract exchange are standardized contracts and reliable enforceability.

a. Standardized Contracts

In "our legal lore," a contract is formed by the mutual agreement of the parties who have almost total discretion to structure and draft their agreement as they see fit.\textsuperscript{14} Such freedom is basic to contract law in the United States. Contract customization, of course, has many positive features. For example, individualized contracts can be tailored to the mutual desires of the parties. Yet, the terms of contracts created or traded on exchanges are not decided by the parties to the specific contract, but are dictated by a third party—usually the exchange itself—leaving only the price as a matter of debate.\textsuperscript{15} All of the

\textsuperscript{12} See infra Section I.B.

\textsuperscript{13} This discussion owes a great deal to the discussions of futures exchange characteristics in Romano, supra note 7, at 10-16; and Mark D. West, Private Ordering at the World's First Futures Exchange, 98 Mich. L. Rev. 2574, 2584-87 (2000).

\textsuperscript{14} Friedrich Kessler, Contracts of Adhesion—Some Thoughts About Freedom of Contract, 43 Colum. L. Rev. 629, 630-31 (1943).

\textsuperscript{15} See Hershey v. Energy Transfer Partners, L.P., 610 F.3d 239, 242 (5th Cir. 2010) ("The public markets for futures standardize the contracts. Everything, except for price, remains the same from
material terms of an exchange-traded contract are standardized, as is the underlying subject matter.\textsuperscript{16} Even if both parties wished to alter some clause, and agreed on precisely the change to be made, they would be powerless to customize their agreement. This is because a contract with malleable terms could not realistically be created or traded on an exchange. A standardized contract is needed for both a primary and a secondary market.\textsuperscript{17}

As to a primary market contract exchange, standardized terms are essential because the use of a uniform contract allows exchange participants to directly compete on price. For example, if Trader A offered a contract with clause $x$ for $10$ and Trader B offered a similar contract containing clause $y$ for $12$, it would not be immediately clear which was the more attractive offer. But if the exchange standardizes the contract so that both contracts contain clause $x$ but not clause $y$, then it will be apparent at a glance which is the better deal. That is to say, the standardization of terms reduces information costs for participants in a primary market on a contract exchange.\textsuperscript{18} After reviewing a single exemplar of the contract, they can focus exclusively on the price.\textsuperscript{19}

The underlying subject matter of the contracts traded must also be standardized in order to easily compare the offers from various traders. For instance, all wheat traders agree that every bushel of wheat that is graded No. 2 Soft Red Winter wheat is identical to every other bushel so graded.\textsuperscript{20} In fact, this is emphatically not so. Despite the efforts to which exchanges go to ensure uniformity,\textsuperscript{21} there will always be many small differences in the actual bushels, even within a grade.\textsuperscript{22} Nevertheless, these differences are immaterial—or at least the traders implicitly agree to treat them as such.\textsuperscript{23}

\textsuperscript{16} The subject matter of the contract must be identical because it would be impossible to have fungible contracts that relate to subject matters that differ.


\textsuperscript{19} See \textit{KOLB & OVERDAHL}, \textit{supra} note 5, at 8 (“This uniformity helps to promote liquidity.”).

\textsuperscript{20} See CBOT RULEBOOK, \textit{supra} note 9, § 14101.

\textsuperscript{21} See, e.g., id. § 14104 (distinguishing grades of wheat based on whether they average two, three or four parts per million of a certain impurity).

\textsuperscript{22} E.g., Leslie Josephs, \textit{Aging Coffee Stocks Push Exchange To Act}, WALL ST. J., Dec. 16, 2010, at C7 (“Responding to a growing buzz that its stockpiles of arabica coffee include beans far past their prime, IntercontinentalExchange Inc. last week said it will . . . prohibit beans too old to make good coffee from being delivered against the contract.”).

\textsuperscript{23} But see Leslie Josephs, \textit{ICE Adds Brazilian Coffee Beans to Its Mix}, WALL ST. J. ONLINE (Dec. 9, 2010), http://online.wsj.com/article/SB10001424052748704720804576010111804632734.html (reporting that when the world’s leading coffee futures contract added Brazilian-grown arabica beans to
Standardization is also essential for a secondary market. Just as agricultural goods or other commodities must be fungible to be traded—every barrel of West Texas sour crude oil is equivalent to every other—so too must a contract to buy or sell the oil be fungible to be traded on a secondary market. By standardizing the contracts traded, an exchange “deliberately creates a homogenous good that can be traded anonymously by the participants.” In other words, a liquid market in a commodified asset—whether an ounce of gold or a standardized contract for the sale of an ounce of gold—is only possible when each unit of that asset is equivalent to every other. Thus, every clause in an exchange-traded contract (save the price) must be specified and set in stone, with no exceptions allowed for anyone. This standardization of exchange-traded contracts makes them “more akin to frozen pork bellies than to what lawyers consider contracts.” They are “contracts as commodities.”

The exclusive use of standard form contracts on the exchange yields a major benefit to all participants: it facilitates a vibrant, liquid market for the contract—and liquidity is valuable in and of itself. That is to say, all else being equal, people and firms prefer a liquid asset to an illiquid one. This basic financial concept is familiar to anyone who has observed that interest rates offered on savings or checking accounts that can be withdrawn on demand are consistently lower than those offered for certificates of deposit (“CDs”) that cannot be withdrawn for a set period of time. Hence, contract exchanges create value by facilitating a liquid market for standardized contracts.

In addition, when trading standardized contracts, a party can “easily and cheaply offset and close a position” by “engaging in an opposing transaction” the types that may be delivered against the contract (at a nine cent discount), critics complained that because Brazilian beans are widely viewed as inferior—“[t]he commodity on this contract won’t be homogenous.”)

24. Telser & Higinbotham, supra note 15, at 997; see Romano, supra note 7, at 10 (noting that “homogenous units” of the contract “eliminate[] disputes over value and guarantee[] abundant supply so that market competition sets prices”).

25. KOLB & OVERDAHL, supra note 5, at 8.

26. Id. at 6; see also 1 SHERMAN, OHIO RESIDENTIAL REAL ESTATE, § 3.06, at 3-7 (2008) (“If the form note and mortgage are altered in any way, the secondary market will not purchase the loan. For that reason, there is no room for negotiation.”).

27. Greely, supra note 18, at 135.

28. Id.


30. On a larger scale, several major financial institutions, including Bear Stearns and Lehman Brothers, went out of business virtually overnight during the recent financial crisis due, in large part, to a sudden lack of liquidity for the assets they held.

31. KOLB & OVERDAHL, supra note 5, at 4.
For instance, a party that sold a contract to deliver 5000 bushels of corn in September for $500 can "cancel out" that trade by buying (sometime before September) a contract to receive 5000 bushels of corn in September for $500.

Were the contract an idiosyncratic negotiated contract, one would "have to take or make physical delivery of the underlying asset" or try to "find someone willing to assume their side of the contract"—a costly, time-consuming and uncertain enterprise.

Next, this Article addresses contract standardization in the context of a traditional futures exchange like CBOT. But before addressing futures, it explains their evolutionary ancestor, the forward contract. A forward contract is an agreement between two parties for the purchase and sale of a commodity, with delivery and payment to take place at a specific time and place in the future. It is a very useful type of contract that has been used in commercial markets for thousands of years.

A simple example is a forward contract made in April by a farmer and a restaurant owner. The farmer plans to plant corn in May and harvest it in August. The restaurateur plans to serve corn for a special menu in September. The two parties can enter into a forward contract whereby the farmer promises to deliver 275 ears of red corn and 225 ears of yellow corn to the restaurant on the first of September, and the restaurateur promises to pay $100 upon delivery. The farmer and restaurateur could simply wait until September 1 and seek out a transaction on the cash or "spot" market at that point, but the forward contract allows the farmer to lock in a buyer and a price for the crop before planting it, and ensures the restaurateur will have corn to serve in September. This process of protecting oneself from future swings in the spot market price is called "hedging."

What if the restaurant changes its menu and the restaurateur no longer has any need for the corn? It would be best if the restaurateur could find someone else who needs corn and would be willing to accept the rights and obligations of the forward contract. But because the restaurateur’s contract with the farmer

32. *Id.* at 17 ("By far, most futures contracts are completed through offset or via a reversing trade."); Romano, *supra* note 7, at 12.

33. Theoretically, the exchange could force the trader to deliver 5000 bushels of corn and receive $100, then immediately pay the $100 and take 5000 bushels of corn, leaving him exactly where he started. But to avoid this waste of effort, the exchange just "zeroes out" the trader’s account.


35. KOLB & OVERDAHL, *supra* note 5, at 3 (noting that "futures contracts evolved from forward contracts"); Joseph M. Burns, *Trading in Futures Markets*, 38 FIN. ANALYSTS J. 33, 34 (1982) ("A futures exchange may be viewed as the application of economies of scale to forward contracts.").

36. KOLB & OVERDAHL, *supra* note 5, at 1; Romano, *supra* note 7, at 7.


38. See Romano, *supra* note 7, at 7.

was a negotiated agreement, it contains idiosyncrasies—odd quantities, multiple varieties of corn, and delivery to the restaurant—that make it much less valuable to a third party. It is therefore difficult, if not impossible, for the restaurateur to sell the interest in the forward contract. Had the contract called for, say, 500 ears of white corn delivered to the central train station, it would be much easier to find a buyer for the rights under the contract. This issue is endemic to forward contracts: because they are individually customized to the wishes of the original parties, they are as a class worth less to third parties than they would be if they were formulaic.

It took several thousand years, but the liquidity problem was finally solved through the creation of futures contracts. In contrast with individually negotiated forward contracts, futures contracts call for a carefully described and graded underlying commodity to be delivered at a specific place and time, and in a certain manner. This standardization of the underlying subject matter paves the way for standardization of the contracts themselves.

Unlike forwards, which are one-on-one private transactions, futures are created and traded on an organized contract exchange. It is the futures exchange itself—not either of the parties—that drafts the terms of the contract. These terms, generally found in the rules of the exchange, are nonnegotiable and highly specific. For example, the butter futures contract traded on the Chicago Mercantile Exchange ("CME") is for 40,000 pounds of USDA Grade AA frozen butter, delivered to an approved warehouse "on any business day of the contract month except that delivery may not be made prior to the third business day following the first Friday of the contract month." Every butter contract on the CME has identical terms, and no trader is permitted to alter them in any way. And, as explained above, this standardization has the important effect of making futures contracts into fungible commodities that can easily be priced and traded on a liquid market.

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40. See Romano, supra note 7, at 12-13.
41. Id.; see Greely, supra note 18, at 139.
42. KOLB & OVERDAHL, supra note 5, at 8; Romano, supra note 7, at 10. The first forward contracts may have been made as early as 1894 B.C., KOLB & OVERDAHL, supra note 5 at 2-3, but the first futures contracts were not entered into until the seventeenth century, West, supra note 13, at 2574.
43. See, e.g., NRT Metals, Inc. v. Manhattan Metals (Non-Ferrous) Ltd., 576 F. Supp. 1046, 1051 (S.D.N.Y. 1983); 1 PHILIP McBRIDE JOHNSON & THOMAS LEE HAZEN, DERIVATIVES REGULATION § 1.02[3], at 25 (2004) ("A key feature of these futures contracts is their standardized, uniform terms. . . . The terms of a futures contract are not negotiable between the parties; they must be accepted by both"); KOLB & OVERDAHL, supra note 5, at 6 (noting that a "major difference between forward and futures contracts is that futures contracts always have standardized contract terms").
44. KOLB & OVERDAHL, supra note 5, at 3. Compare Romano, supra note 7, at 7-10 (describing idiosyncratic forward contracts that are not traded on exchanges), with id. at 10-16 (describing standardized futures contracts that are traded on exchanges).
45. E.g., CBOT RULEBOOK, supra note 9.
46. CME RULEBOOK, supra note 9, §§ 5100, 5103.B, 5104.C.
47. See Breyer v. First Nat'l Monetary Corp., 548 F. Supp. 955, 963 (D.N.J. 1982); KOLB & OVERDAHL, supra note 5, at 6-8 ("[T]he difference between forward and futures contracts is that futures
b. Reliable Enforceability

The second necessary attribute of a contract exchange is that the traded contract must be reliably enforceable at law. By "reliable" enforceability, this Article means the general level of enforcement that American law gives to ordinary contracts. No contract is bulletproof. There is always a chance that the party resisting enforcement will claim duress or declare bankruptcy or set up some other defense to enforcement, but contracts are, as a rule, reliably enforceable in the United States. A legal opinion letter, for instance, commonly includes a statement that a given contract "is a valid and binding enforceable obligation," even though the drafter well knows that a court might refuse enforcement on, say, statute of limitations grounds. This is the level of enforcement necessary for a modern contract exchange.

As a general matter, legal enforceability is what gives a contract value. A contract that is not enforceable is not really a contract—it is just a promise. A bare promise may have some value in certain situations, thanks to private and informal methods of enforcement. Lisa Bernstein, Robert Ellickson, and others have documented examples of groups that opt out of legal enforcement, including diamond dealers and cattle ranchers. However, such "relational contracting" is a realistic alternative to legal enforceability only when the contracts always have standardized terms. . . . [F]utures contracts are highly uniform with well-specified commitments for a carefully described good to be delivered at a certain time and in a certain manner. Generally, the futures contract specifies the quantity and quality of the good that can be delivered to fulfill the futures contract. The contract also specifies the delivery date . . . . This uniformity helps to promote liquidity.

49. Rudbart v. N. Jersey Dist. Water Supply Comm’n, 605 A.2d 681, 682-83 (N.J. 1992) ("The transfer of securities in the primary and secondary market hinges upon the certainty of the terms of such securities, and the assurance that those terms cannot be overridden by judicial fiat."); Gerald D. Gay & Joanne T. Medero, The Economics of Derivatives Documentation: Private Contracting as a Substitute for Government Regulation, 3 J. Derivatives 78, 86 (1996) (nothing that the effectiveness of a contract exchange "depends critically upon the legal certainty of enforceability"); Telser & Higinbotham, supra note 15, at 971 (stating that a "necessary feature" of a contract exchange is that "some legal entity is liable for fulfilling the terms of the contract").

50. See HERITAGE FOUNDATION, United States, in 2011 INDEX OF ECONOMIC FREEDOM (2011) (stating that "contracts are secure" in the United States); RESTATMENT (SECOND) OF CONTRACTS § 1 (1981) ("A contract is a promise . . . for the breach of which the law gives a remedy . . . .")


52. Mark West has shown that at the "world's first organized futures market," the lack of legal enforceability of the contracts traded was not a hindrance. See West, supra note 13, at 2576, 2605. But that exchange was established in Japan under a shogunate system of government that refused to enforce most private contracts, leaving them to private resolution instead. Id. at 2605-06. So the exchange-traded contracts were treated the same as other types of contracts, which is really all that is required.

53. RESTATMENT (SECOND) OF CONTRACTS § 1 (1981) (defining "contract" as "a promise . . . for the breach of which the law gives a remedy").

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parties know each other personally and deal with each other repeatedly over time. Outside of these unique circumstances, legal enforceability, at least as a background rule, is essential to convince people to make contracts with unknown parties at arm’s length.

This reality is particularly true of contract exchanges because the essential goal of any such exchange is to facilitate anonymous trades among strangers. It is hypothetically possible for a contract exchange to serve only a limited number of participants who know each other, but the nature of an exchange is that its success is directly dependent on the number of participants: the more, the better. Thus, in the usual case—where there are a large number of exchange participants that are strangers to one another—reliable legal enforceability is necessary for the exchange to function.

Futures contracts traded on traditional exchanges are, as they must be, reliably enforceable at law. Judicial enforcement of futures contracts rarely arises in practice, of course, because the vast majority of futures contracts are closed out through “offset” or by a “reversing trade.” But it is fundamental that a party has the power to hold a future until the delivery month, at which point “the futures contract becomes a presently enforceable contractual obligation” to deliver or pay for the named commodity.

The principle that exchange-traded contracts must be reliably enforceable at law was demonstrated in recent years when organized exchanges for energy futures and other novel derivatives grew to significant size. Under an ancient common law rule, “difference” contracts—those where the parties do not really


57. Telser & Higinbotham, supra note 15, at 997-98 (explaining that a contract exchange “deals in a highly fungible good that is readily traded among strangers”).

58. Id. at 997 (“The benefit of an organized market is an increasing function of the number of potential participants.”).

59. Hershey v. Energy Transfer Partners, L.P., 610 F.3d 239, 242 (5th Cir. 2010) (“If a short party holds the future until it comes due, . . . then the futures contract becomes a presently enforceable contractual obligation to deliver the natural gas.”); see Tafara & Peterson, supra note 56, at 158 (“[Futures markets succeeded in nineteenth-century America because] market participants—intermediaries, producers and consumers—understood that the agreements they entered into would be honored. They knew they would have [legal] recourse if a contract were broken”).

60. KOLB & OVERDAHL, supra note 5, at 17.

61. *Hershey*, 610 F.3d at 242; Romano, supra note 7, at 13 (“[E]ven though cash settlement (by contract reversal) is the most typical method of settlement in futures markets, the physical delivery option is critical.”).

intend to perform but merely "to speculate in the rise or fall of prices"—are illegal and unenforceable, and some uncertainty developed over whether these new derivatives would be enforced the courts.63 Traditional futures, such as those traded on CBOT, are regulated by the Commodity Futures Trading Commission ("CFTC") and therefore exempt from the common law ban on difference contracts. But energy futures and their ilk were not regulated by the CFTC, potentially leaving parties without the option of legal enforcement.64 This legal uncertainty threatened the entire industry. Had a court ruled that an energy future, for instance, was in fact an illegal difference contract, "trillions of dollars in outstanding swaps could have been invalidated," potentially causing enormous upheaval in the energy market and others.65 Fortunately, the CFTC and Congress recognized the problem and quickly clarified the law to make these novel derivatives enforceable.66 This vignette shows that reliable legal enforceability is, indeed, necessary to a functioning contract exchange.

This is not to say that contract exchange participants regularly sue each other to enforce their contracts. The "shadow" of the law—the parties' awareness that the contract could be enforced with all the power of the state if necessary—is the important thing.

2. Useful Institutional Attributes

In addition to the two prerequisite institutional attributes discussed in the previous Subsection, there are a number of characteristics that are valuable, but not absolutely necessary, for a contract exchange to function.67 This Subsection briefly highlights a few of the most useful and beneficial optional institutional attributes of contract exchanges: clearinghouses, margin and membership requirements, and price discovery. The traditional futures exchange possesses all of these optional characteristics.

63. Stout, supra note 17, at 714-15; see also Irwin v. Williar, 110 U.S. 499, 510 (1884) ("[I]n this country, all wagering contracts are held to be illegal and void as against public policy.").


65. JICKLING, supra note 62, at 3; Ford & Liao, supra note 64, at 907 (describing the "chaos" that would ensue in financial markets if energy futures contracts were invalidated); Anna Stolley Persky, Do the Math: The Role of Derivatives in Fiscal Fallout, WASH. LAWYER, June 2010, at 22, 27 ("[I]f these swaps had been voidable, it would have created a crisis.").

66. JICKLING, supra note 62, at 3; Ford & Liao, supra note 64, at 907-08.

67. In this way, these attributes are akin to the trademarked tagline for BASF chemical company, "At BASF, we don't make a lot of the products you buy. We make a lot of the products you buy better." Registration No. 2,988,793.

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a. Clearinghouse

A clearinghouse is a legal entity that guarantees the performance of every contract traded on an exchange.68 It provides this guarantee by formally entering into both sides of every contract created on the exchange: "The clearinghouse becomes the seller to the buyer of the contract, and the buyer to the seller."69 This guarantee facilitates a primary purpose of contract exchanges, anonymous trading among strangers,70 by eliminating "counterparty risk," or the chance that one's contracting counterparty will fail to perform.71 This adds value to a contract exchange and benefits its participants. By relieving participants of the need to conduct due diligence on their trading partners, a clearinghouse reduces transaction costs.72

In truth, counterparty risk can never truly be "eliminated." All a clearinghouse really does is shift the locus of the risk to itself. "Because of the clearinghouse, the two trading parties do not need to trust each other or even know each other's identity. Instead, the two traders only have to be concerned about the reliability of the clearinghouse."73 Thus, the more confidence traders have that the clearinghouse will perform its guarantee, the better the exchange functions.

In the archetypical contract exchange, the futures exchange, the clearinghouse has proved quite reliable. In the United States, at least, futures clearinghouses are all well-capitalized and regulated entities that have always performed as promised.74 There has never been an instance of a futures clearinghouse default, even during the recent financial crisis.75 This has led futures traders to put tremendous faith in their clearinghouses,76 which has, in turn, encouraged futures exchanges to flourish.77

b. Margin

The reduction in risk offered by a clearinghouse is not cost-free, of course. The clearinghouse, like any provider of insurance, will demand compensation for guaranteeing the performance of every contract on the exchange. The usual

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68. KOLB & OVERDAHL, supra note 5, at 9. A "guarantee" is a promise to perform in the event that the primary obligor fails to do so. 1 FARNSWORTH, supra note 7, § 6.3, at 107.
69. West, supra note 13, at 2587; see Romano, supra note 7, at 16-17.
70. See Tesler & Higinbotham, supra note 15.
71. KOLB & OVERDAHL, supra note 5, at 11.
72. Bums, supra note 35, at 34.
73. KOLB & OVERDAHL, supra note 5, at 11; id. at 9 ("[T]he clearinghouse substitutes its own credibility for the promise of each trader in the market.").
74. Id. at 11.
75. Id.; Romano, supra note 7, at 21.
76. While this means that a clearinghouse's failure to perform when needed "would bring the futures market to ruin," the risk of such an outcome is "very small." KOLB & OVERDAHL, supra note 5, at 11.
77. See infra Section I.B.
method for paying the clearinghouse is by requiring traders to transfer to the clearinghouse some portion of their potential liability, called "margin," before entering into any contracts. Margin serves as a bond to encourage traders to perform their contract, as well as a means of funding the clearinghouse. 78

The level of margin required depends on the exchange. A typical futures contract might require a margin of 5%, meaning that a trader would have to post 5% of the current market value of a given contract before being allowed to trade. If the market moves against the trader, the clearinghouse will require an additional margin. This is called a "margin call." 79 The combination of margin requirements and clearinghouses greatly enhances the ability of traders to ignore counterparty risk when they trade.

c. Membership

Yet, another means for enhancing the ability of traders to ignore counterparty risk is a rule that only approved parties (that is, members) may trade on a contract exchange. 80 In general, to qualify for membership, parties must demonstrate their integrity and financial responsibility. 81 This provides traders with further comfort that counterparties can be trusted to perform their contracts, even if it means suffering a significant loss.

d. Price Discovery

When two parties make or trade a contract on an exchange, the price is generally posted for all traders to see. These prices can convey useful information not only to exchange participants but also to others. 82 This is called "price discovery." 83 For example, using the information contained in today's futures prices, one can estimate what the price of a given commodity will be at a given time in the future. 84

The time-sensitive and valuable price information is often first posted on the exchange, then conveyed to paying subscribers, 85 and then, after a suitable

78. KOLB & OVERDAHL, supra note 5, at 12.
79. Id. at 12-13.
80. Id. at 4-6; Telser & Higinbotham, supra note 15, at 972-73.
81. JOHNSON & HAZEN, supra note 43, § 1.04[1], at 153 (“The rules of the derivatives exchange set qualifications for membership that generally focus on matters of integrity and financial responsibility.”).
82. Telser & Higinbotham, supra note 15, at 997 (“[T]he transactions prices alone convey a considerable amount of useful information to those who are not currently trading in the market.”).
83. E.g., KOLB & OVERDAHL, supra note 5, at 24-25; Romano, supra note 7, at 14-15.
84. KOLB & OVERDAHL, supra note 5, at 25 (explaining how this “serve[s] a social purpose by helping people . . . make their consumption and investment decisions more wisely”).
85. See Bd. of Trade of the City of Chi. v. Christie Grain & Stock Co., 198 U.S. 236, 250-51 (1905) (holding that CBOT's "collection of quotations is entitled to the protection of the law . . . like a trade secret"); KOLB & OVERDAHL, supra note 5, at 100 (“The sale of real-time transaction prices, quotations, and other market data is a huge source of revenue for financial exchanges such as the . . .

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delay, publicly disseminated. And so long as the information reaches the public within some reasonable time, it redounds to the benefit of all, including consumers and others with no direct connection with the exchange.

This public disclosure of transaction prices serves a valuable democratizing function. In the absence of such disclosure, the wealthy and powerful possess significant informational advantages thanks to their knowledge of market conditions. For example, a large corn dealer that buys from many small farms understands the general state of the crop (and therefore the likely level of supply at harvest time) much better than any of the individual farmers. But a grain futures exchange places price information in the hands of any farmer with access to a newspaper (or the Internet), thereby greatly reducing the dealer’s advantage vis-à-vis the farmers. For consumers, the argument is a bit weaker. It is the rare motorist that consults the gasoline futures market in January to decide whether to take a road trip in June. For this reason, the benefit of price discovery for consumers is real, but modest.

B. Benefits and Costs

Contract exchanges, by providing competitive, liquid markets for entering into and trading standardized contracts, yield a number of private and public benefits, many of which have already been mentioned. The liquidity of the market assures a fair price for all concerned, and the contracts traded can be used for a variety of business purposes, most notably to hedge risk. Contract exchanges also reduce transaction costs in a variety of ways, including standardizing contracts and gathering buyers and sellers together in one place.

CBOT."); see also Jason Zweig, Exchanges Pushed by a Need for Speed, WALL ST. J., Feb. 10, 2011, at C1 (recounting that at “the time of the Civil War, the New York Stock Exchange Board . . . charged outside brokers up to $100 to put their ears up to a keyhole where they could eavesdrop on trading activity”).

86. See KOLB & OVERDAHL, supra note 5, at 94 (noting that the Wall Street Journal “publishes futures prices daily”).

87. Stone, supra note 4, at 197 (“[B]oards of trade stand for equity.”).

88. Cf. Dana Cimilluca & Guy Chazan, IPO Sets the Stage for Deals, WALL ST. J., Jan. 27, 2011, at C1 (reporting that many of the world’s largest commodities firms “aren’t publicly traded and often operate in great secrecy, benefiting from the often specialized knowledge they gain from both producing and shipping goods around the world and adjusting quickly to rapid-fire changes in supply and demand”).

89. Stone, supra note 4, at 197 (noting that futures exchanges “bring[] to the knowledge of the grain dealer and farmer all facts which are necessary for them to know, in order to arrive at the intrinsic value of their grain”).

90. West, supra note 13, at 2599; see also KOLB & OVERDAHL, supra note 5, at 6.

They also provide a lawful and "legitimate outlet for speculative capital" by providing a market able to absorb even very large transactions with little effect on prices. Contract exchanges have been shown to stabilize prices and reduce credit needs, time delays, and risk. In short, contract exchanges facilitate efficient, anonymous transactions among strangers to the great benefit of those who participate.

Contract exchanges also confer benefits on nonparticipants, including consumers, and are therefore in the public interest. Hence, the federal government has encouraged or required contract exchanges on numerous occasions over many years. For one thing, contract exchanges help reduce the incidence of scarcity and glut by providing insight into expected future market conditions. This is particularly important with respect to agricultural commodities, as scarcity could lead to famine. And by quickly and efficiently conveying useful information to myriad markets, contract exchanges are vitally important to economic growth, which is in the public interest.

92. Lurie, supra note 4, at 27; Romano, supra note 7, at 32 ("In the public imagination, speculator is a decidedly pejorative term. But the speculator's function in futures markets is absolutely essential.").

93. Tesler & Higinbotham, supra note 15, at 997 (arguing that uncertainty about individuals and their reliability in futures trading can be reduced by replacing their identity with that of the institution or organized market).


95. Telser & Higinbotham, supra note 15, at 997.


98. Lurie, supra note 4, at 24-26; Romano, supra note 7, at 12-13 ("Individuals with information that the future direction of spot prices will be different from what current prices suggest will trade in the futures markets. Their activity conveys information about prices and moves spot market prices in the correct direction.").


100. Stone, supra note 4, at 197 ("[The futures trading system] is in the interest of the general prosperity, and of the common commercial welfare. It is an absolute economic necessity."); Charles
Despite their general democratizing effect, however, traditional contract exchanges have over time become dominated by wealthy and sophisticated players. In part, this is because membership on a major contract exchange can cost a million dollars or more. Moreover, even if membership were more affordable, it is physically impossible to have more than a few dozen individuals trading in a pit at any given time. And while electronic trading could allow for "virtual" trading pits of tremendous size, the traditional exchanges still have only a very small number of seats. The result is that consumers cannot, and do not, directly participate in traditional contract exchanges; only sophisticated professionals do.

That said, although they cannot trade directly on an exchange, consumers (or farmers) can fairly easily trade contracts through a broker. This comes, however, with a transaction fee. And whether the fee is large or small in an absolute sense, it will certainly be more burdensome for smaller traders because it will represent a larger percentage of their overall transaction. It might be reasonable to hedge $10,000 worth of corn for a $100 fee, which is just 1% of the total transaction. But for a very small farmer who expects to sell only $1000 of corn, the same $100 fee is 10% of the total transaction and likely prohibitively expensive. That is, the farmer will not be able to hedge and will be forced to take a chance on the spot market. The result is that anyone can trade on traditional contract exchanges through a broker in theory, but in practice it is generally not worthwhile for parties with small sums at stake—such as consumers—to do so.

There are other costs to contract exchanges as well. They deny contracting parties the ability to negotiate their agreements, making it impossible to
precisely meet to their needs. A party might only want 100 pounds of butter, but the standard CME contract, which is not negotiable, is for 40,000 pounds. This is not only inconvenient, it is contrary to the core notion of contracts as negotiated agreements. And a contract exchange may make it easier for a single party to “corner the market” and then act in a monopolistic fashion.

Contract exchanges also undermine companies’ efforts to brand themselves, thus snuffing out the ability of businesses to communicate useful information, for example that their product is of reliably high quality. Companies have an incentive to invest in quality if they can earn a return on that investment in the form of consumer loyalty. But when a business is commoditized—for example, every bushel of No. 2 Soft Red Winter wheat is viewed as equivalent to every other—the incentive is to invest enough to make the grade, and no further.

This effect has been on display in recent years in the airline industry. Many consumers shop for airline tickets using online tools that rank offers by price, thus treating them as fungible commodities. In response, many airlines have taken to competing solely on the basis of price, leading to a widely remarked upon negative effect on airline service: delays are common; meals and drinks are no longer provided; and fees have been imposed to travel standby, make a reservation by phone, or check luggage (or even, sometimes, carry it on).

In addition, one must recognize what might be called ethical or moral concerns over the standardization and commodification inherent in all contract exchanges, in that they undermine diversity and regional variation. For example, the great variety of crops that existed in nineteenth-century America has been winnowed into just a handful of standardized varieties, leaving many nostalgic for the “heirloom” varietals eaten by our forebears.

108. CME RULEBOOK, supra note 9, § 5102.B.
110. See infra note 133.
112. MICHAEL POLLEN, THE BOTANY OF DESIRE 192-94, 225-29 (2002) (criticizing “monoculture” and celebrating the many varieties of potatoes cultivated by the ancient Incas as “an extraordinary cultural achievement and a gift of incalculable value to the rest of the world”); see CARY FOWLER & PAT MOONEY, SHATTERING: FOOD, POLITICS, AND THE LOSS OF GENETIC DIVERSITY (1990); Nancy Lofholm, Foreseeding the Future: CSU Seed Bank Is Insurance Against Global Changes, DENVER POST, Sept. 20, 2007, at A1 (“[T]he 8,000 crop varieties that were growing in the U.S. in the early 1900s have dwindled to 600.”).
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exchanges are not the sole cause of this phenomenon—other likely culprits include technology, culture, and patent law—but they have surely exacerbated it by requiring uniformity of the underlying crops.

These costs of contract exchanges are real, but the benefits appear to be overwhelming. The reduction of hunger as a social problem easily outweighs the loss of certain varieties of fruits and vegetables, and lower prices for airline tickets are considered by many, if not most, consumers to be worth the loss in service. Thus, contract exchanges have long been broadly popular, and new exchanges and contracts continue to develop. And for those consumers who prefer (and wish to pay for) a higher level of service, they can eschew the exchange and contract directly for branded goods and services, such as heirloom tomatoes from a farmer's market or a first-class airline seat.

Historically, the strongest opposition to contract exchanges has come from entrenched interests that have some advantage or control in the relevant market. They understand all too well that the introduction of a contract exchange will whittle away their profit margins. In the 1950s, for instance, large onion growers successfully lobbied Congress to ban onion futures. More recently, financial firms that design and trade complex derivatives (unsuccessfully) fought legislation requiring that all such derivatives be traded on an exchange, and film producers (successfully) lobbied Congress to ban the

113. E.g., Scott McCartney, With Low Fares, Furor over Carry-On Fees Wanes, WALL ST. J., Oct. 14, 2010, at D3 (reporting that Spirit Airlines's policy of charging up to $45 to carry luggage on board, which had initially attracted the ire of consumers and Congress, has proved popular due to lower ticket prices and fewer delays); Susan Stellin, When Is Cheap Not Enough?, N.Y. TIMES, Aug. 22, 2010, at TR3 (stating that author purchased airline ticket from Spirit for $112 instead of from competitors that charged nearly $600: "For that price difference ($500!), I was willing to make some sacrifices . . .").

114. KOLOB & OVERDAHL, supra note 5, at 19 (“Since the founding of the CBOT in 1848, futures markets have flourished. The past three decades have been a period of extraordinary growth . . .").

115. Some may worry that the market power of a contract exchange could crowd out alternatives for those consumers that would have preferred to make individual contracts for branded goods and services, leaving them no choice but to accept the commodified contract. This worry is a valid concern in theory, but in practice, there seems to be no lack of individualized, branded options where we already see exchanges, such as hotel rooms or airline tickets. See Stephen Heyman, Affordable Boutique Hotels? in New York?, N.Y. TIMES, June 20, 2010, at TR1 (reporting on a “huge wave of consumer demand” for “boutique hotels” that offer “cool design” and “nods to local flavor”); Holman W. Jenkins, Jr., The Airlines Discover “Content,” WALL ST. J., Jan. 21, 2011, at A11 (describing attempts by airlines to “de-commodify the basic airline seat” and “to cozy up to the customer so he can be sold more and more services”).

116. Blinder, supra note 17 (“[S]tandardized, exchange-traded products . . . squeeze profit margins to the bone.”). See generally Epstein, supra note 91, at 817 (“People in any mainstream business call something a ‘commodity’ because imitation and dissemination have sucked out all the monopoly rents from the project.”).


118. Blinder, supra note 17 (“Derivatives dealers have already shed crocodile tears over the alleged benefits of customization . . .").
trading of futures on Hollywood movies’ box-office receipts. These interested parties recognize that they stand to lose from the establishment of a contract exchange. But their loss is the public’s gain.

It is true that certain derivatives—credit default swaps and mortgage-backed securities—have been subject to much criticism of late as a possible cause of the recent financial crisis. But any such problems were generally absent in standardized contracts traded on organized contract exchanges (for example, those for “conforming” mortgages) and rather were found in customized contracts not traded on exchanges (such as “subprime” mortgages). Hence, far from eschewing contract exchanges, the new Dodd-Frank Act requires much more extensive use of them.

On balance, contract exchanges are strongly in the public interest. One significant shortcoming, however, is that consumers have not had the opportunity to directly participate. But a new form of contract exchange, one focused on consumer contracts, has recently appeared to fill that gap.

C. Consumer Contract Exchanges

Contract exchanges have traditionally been located in large “exchange halls” in major cities. Because space is limited in even the largest halls, only a relatively small group of people can directly participate in a traditional contract exchange. The result is that wealthy and sophisticated parties have long reaped the many benefits of participating in contract exchanges, but ordinary consumers have not.

Over the past decade, however, inexpensive and widespread access to the Internet has rendered physical constraints irrelevant for many purposes. A


121. Telser & Higinbotham, supra note 15, at 971 (providing “a theory of the net benefit of an organized exchange”).

122. See supra text accompanying notes 101-107.

123. See Bd. of Trade of City of Chi. v. Christie Grain & Stock Co., 198 U.S. 236, 245 (1905) (The “main feature” of CBOT is that “it maintains an exchange hall for the exclusive use of its members, which now has become one of the great grain and provision markets of the world. Three separated portions of this hall are known respectively as the wheat pit, the corn pit, and the provision pit.”).


125. Indeed, most futures contracts are traded today on electronic trading platforms, rather than via the “open outcry” method. Kolb & Overdahl, supra note 5, at 5.
contract exchange no longer needs to have a physical location to bring traders together in one place. 126 A web-based contract exchange can be just as centralized and organized as a physical one, if not more so. And this has made possible a new form of contract exchange—one without seats or members that invites consumers to participate. 127

This new form—a "consumer contract exchange"—is an exciting development that holds the promise of bringing the liquidity, price discovery, and other benefits of contract exchanges directly to consumers. Anyone who has ever used Priceline to "name their own price" for an airline ticket or Hotwire to book a room without knowing the identity of the hotel has experienced the power of consumer contract exchanges. And these primitive consumer contract exchanges may prove to be just the beginning of a new way for consumers to flex their collective bargaining power.

This Section recognizes several extant consumer contract exchanges and describes their institutional structures in terms of the definition and institutional attributes established in Section I.A. 128 It begins with exchanges for consumer-to-business contracts and then moves on to exchanges for consumer-to-consumer contracts.


Consumers understand the value of subjecting the businesses they deal with to intense price competition. 129 As a result, contract exchanges for consumer-to-business transactions have flourished on the Internet. In general, these exchanges consist of a website where a consumer can make a request for a generic good or service and receive a number of offers from businesses competing to fulfill the request. The result, as predicted by theory, 130 is that consumers obtain exceptionally attractive prices and interest rates.

a. Priceline and Hotwire

Two of the oldest and most popular consumer-to-business contract exchanges are Priceline and Hotwire, both of which provide a marketplace for fungible travel services, such as a two-star hotel room in a given neighborhood,

126. All of the consumer contract exchanges known to this author exist only on the Internet.
127. This can be seen as a specific instance of the broader phenomenon of "disintermediation" that is endemic to the Internet. See Andrew L. Shapiro, Digital Middlemen and the Architecture of Electronic Commerce, 24 OHIO N.U. L. REV. 795, 795-801 (1998) (explaining that disintermediation is a term "used in cyber circles to describe the bypassing of middlemen that technology allows").
128. See supra Section I.A.
129. See, e.g., WHEN BANKS COMPETE, YOU WIN, Registration No. 2,440,603 (slogan of LendingTree online mortgage marketplace).
130. See supra Section I.B.
a certain size rental car, or an airline ticket. On Hotwire, a consumer enters basic information, and businesses present offers for the consumer to accept or reject. The twist is that the consumer is not told the name of the company making the offer, only that it is a reputable brand-name company.  

Take for example a request to rent a compact car at the Miami airport for two days. The consumer will receive anonymous offers at a variety of prices and will generally select the lowest price. Once the consumer has accepted the offer, the name of the company (Avis, Budget, and the like) with whom he just contracted is revealed. Priceline works similarly, except that it uses a "name your own price" method, whereby it is the consumer that makes an offer to an anonymous group of vendors who are then free to accept or reject it.  

It is important to note the distinction between contract exchanges like Hotwire and Priceline, on the one hand, and other travel services websites such as Expedia, Orbitz, or Kayak, on the other. These latter websites operate in much the same way as Hotwire or Priceline, except they lack the all-important aspect of anonymity. A consumer that makes a request on one of these sites to rent a compact car for two days is told the brand name behind each offer. On Kayak, a consumer seeking to rent a car might be given the alternative of a $50 price from a "premium" brand like Hertz, and a $45 price from a "value" brand like Thrifty—and may well end up going with Hertz, thanks to the value of its brand. Contrast that one-to-one transaction with the operation of the contract exchange on Hotwire, where the consumer is not told the name of the service providers making offers of $45 or $50 for the same compact car for the same two days. The consumer is sure to select the $45 option and, unknowingly, select Thrifty. This little difference separates a contract exchange like Hotwire from an ordinary marketplace like Kayak. By keeping the brand opaque, Hotwire allows and requires consumers to treat the car rental like a generic commodity and compare offers purely on the basis of price.  

A consumer who contracts via Hotwire implicitly accepts and agrees that all two-star hotel rooms within a neighborhood, compact rental cars, or coach airline tickets are identical in all material aspects. It is easy to point out that this
is emphatically not true; there are many small differences in the underlying subject matters of these contracts. Just as one bushel of No. 2 Soft Red Winter wheat will differ slightly from another, so too, one two-star hotel room will vary from another. But the important consideration is that the consumer, in deciding purely on price, knowingly treats them as if they were identical. And for a consumer that prefers to deal with a specific company, they can do so directly (or via Kayak) off the exchange, albeit almost certainly for a higher price.\textsuperscript{135}

The first necessary institutional attribute of all contract exchanges, namely the use of standardized contracts, is found on Priceline and Hotwire.\textsuperscript{136} In both cases, the terms of service act as a standard form contract to which all exchange participants must adhere.\textsuperscript{137} Both exchanges also display the other necessary institutional attribute: reliably enforceable contracts. On both exchanges, the consumer must make payment in full at the time of contracting, leaving only the service provider's performance outstanding.\textsuperscript{138} The upshot is that there is never any need to enforce the contract against consumers, for they have already paid in full. And in the usual case, service providers perform with the same regularity as in other contexts. Hence, the contracts created on these exchanges are reliably enforceable, as they must be.

As for the optional institutional attributes of contract exchanges, Priceline and Hotwire make scant use of them.\textsuperscript{139} First, there is no clearinghouse that guarantees performance (although the credit card companies can be seen as playing a related role).\textsuperscript{140} Second, there is no use of margin; to the contrary, the consumer must pay the entire contract price immediately upon making the contract. Alternatively, this can be seen as a margin requirement of 100%. Third, there are no membership requirements on the consumer side; anyone with a credit card is welcome to participate.\textsuperscript{141} On the business side, however, Priceline and Hotwire screen their membership and only allow "brand name" companies "you know and trust" to participate.\textsuperscript{142}

\textsuperscript{135} See 10 Tips to a Great Hotel Rate, supra note 132.

\textsuperscript{136} See supra Subsection I.A.1.a.


\textsuperscript{138} 10 Tips to a Great Hotel Rate, supra note 132 (noting that Priceline and Hotwire both require "a nonrefundable transaction"). Thus, the contracts made on Priceline and Hotwire are all unilateral (promise-for-performance), as opposed to bilateral (promise-for-promise), contracts. See 1 FARNSWORTH, supra note 7, § 3.4, at 189.

\textsuperscript{139} See supra Subsection I.A.2.

\textsuperscript{140} Priceline and Hotwire both affirmatively disclaim any such role. See sources cited supra note 137.


Fourth, neither Priceline nor Hotwire posts prices at which transactions are made, so there is no price discovery on these exchanges.\textsuperscript{143} This is a real and significant shortcoming because it undermines a key public benefit of contract exchanges, but perhaps it will be remedied as these consumer contract exchanges mature. After all, there was a time when CBOT banned telegraphs and soaped up its windows to prevent the public dissemination of trading prices.\textsuperscript{144}

Finally, because contract exchanges have efficiency advantages over other methods of contracting, we should expect that consumers that use Priceline or Hotwire will obtain lower prices than are available elsewhere.\textsuperscript{145} And this is indeed borne out in practice: Consumer Reports has found that prices obtained by consumers on Priceline and Hotwire are the most attractive anywhere, online or off. An extensive 2003 report on the major travel websites concluded: “In all three sectors of this testing—airlines, hotels, and car rentals—either Priceline or Hotwire provided the highest number and percentage of lowest rates.”\textsuperscript{146} Hence, just as theory predicts, consumers—at least that significant group that considers price to be the most important consideration\textsuperscript{147}—are benefiting from their participation in these new consumer contract exchanges.\textsuperscript{148}

b. MoneyAisle

Another example of a consumer-to-business contract exchange is MoneyAisle, a “next-generation online auction marketplace” where consumers can invest in a CD or savings account at a federally insured bank or credit union. The interest rate on the account is determined by “having banks and credit unions actively bid against each other in live auctions for each individual

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\textsuperscript{143} Anecdotal reports indicate that prices obtained on either exchange are sometimes shared on blogs or online message boards, but there is no known systematic reporting of transaction prices. See, e.g., RDU—Extended Stay Hotels $28 on Hotwire, FLYERTALK, \url{http://www.flyertalk.com/forum/hotel-deals/1161828-rdu-extended-stay-hotels-28-hotwire.html} (last visited Apr. 17, 2011) (reporting Hotwire transaction to fellow travellers).

\textsuperscript{144} KOLB & OVERDAHL, supra note 5, at 100.

\textsuperscript{145} See supra Section I.B.

\textsuperscript{146} WILLIAM J. MCGEE, CONSUMER REPORTS WEBWATCH, BOOKING AND BIDDING IN THE BLIND: AN IN-DEPTH EXAMINATION OF OPAQUE TRAVEL WEB SITES (2008), available at \url{http://www.consumerwebwatch.org/dynamic/travel-report-booking-bidding.cfm}. For a more recent report, see 10 Tips to a Great Hotel Rate, supra note 132 (“[D]iscount sites such as Priceline and Hotwire [a]re the only surefire way to reap substantially lower room rates. Respondents who reserved a room at an upscale hotel through a discounter paid an average daily rate of $80. Those who phoned the hotel or booked online by other means paid about $120 for a comparable room.”).

\textsuperscript{147} Vic Kolenc, Holiday Survival: Stores Get Competitive To Bring in Shoppers, EL PASO TIMES (Nov. 21, 2010), \url{http://www.elpasotimes.com/business/ci_16668362} (noting that in a national survey of consumers, 54.5% said price, in the form of “sales, discounts or everyday low prices,” is “the most important factor[.] in choosing where they shop”).

\textsuperscript{148} See supra Section I.B.
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consumer request. The competitive bidding is a boon for consumers, who receive attractive rates. In fact, the process drives rates so high that banks, especially name brand banks, have generally declined to participate. This effect is consistent with the historical treatment of contract exchanges by entrenched market players. Fortunately, there appear to be enough credit unions willing to participate for the exchange to work well.

MoneyAisle possesses both of the required institutional attributes of all contract exchanges. First, the contracts offered, savings accounts and CDs, are sufficiently standardized by federal banking regulations as to be fungible. The MoneyAisle consumer treats the savings accounts and CDs from one bank or credit union as equivalent to those of another and compares them solely on the basis of interest rate.

Second, similar to Hotwire and Priceline, the contracts created on MoneyAisle are of the unilateral variety, as consumers must pony up their funds at the time of contracting. There is no further promise for them to perform. So the only question of enforceability is against the bank, and there is no doubt that a promise by a bank to a consumer to pay a certain rate on a CD is a reliably enforceable promise.

As for the optional attributes of contract exchanges, MoneyAisle does have a clearinghouse and membership requirements, but it has no control over either one. In this case, federal insurance agencies—the Federal Deposit Insurance Corporation (“FDIC”) for banks and the National Credit Union Administration (“NCUA”) for credit unions—play both roles. Those federal agencies guarantee bank and credit union performance up to $250,000. And

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149. Anne Eisenberg, Do I Hear 4%? On This Site, Banks Bid for Your Cash, N.Y. TIMES, Sept. 28, 2008, at BU4 (“When people come to the site shopping for a C.D. or a high-yield savings account, the banks engage in a fast-moving auction. A hundred banks may bid in the first round, 80 in the second round, 50 in the third, until the bank with the highest offer wins the auction. As the bids rise, the interest rates click past on the screen like numbers on the gauge of a gas pump. The customer can take the final deal or leave it. There’s no charge.”); Lauren Rosen, Three Reasons Why You Should Consider Refinancing an Auto Loan, MONEYAISE (Sept. 7, 2010), available at http://www.moneyaisle.com/content/three-reasons-why-you-should-consider/; see also Ray Birch, Consumers Can Now Find CU in the MoneyAisle, 14 CREDIT UNION J., May 17, 2010, at 4 (“All deals are subject to verification, and if consumers have not been truthful or accurate in sharing their credit score, the offer is either withdrawn or the rate changes.”).

150. Eisenberg, supra note 149; Frequently Asked Questions, MONEYAISE, http://www.moneyaisle.com/help/faq (last visited Mar. 29, 2011) (“[B]y having banks and credit unions compete for your specific business in live auctions ... they are compelled to give you the best available rates.”).

151. Birch, supra note 149 (“Fewer than 10 banks [and none of the “mega-banks”] are currently participating.”).

152. See supra text accompanying notes 116-119.

153. Birch, supra note 149 (noting that 85 credit unions “have signed up and 110 are in the pipeline”); see infra note 158.

MoneyAisle only permits members of the FDIC or NCUA to participate in its exchange.\footnote{155} These institutional attributes serve to minimize consumers’ counterparty risk, though they have not completely eliminated at least the perception of such risk.\footnote{156}

Theory predicts that the use of a contract exchange should result in MoneyAisle offering rates to consumers that are more attractive than those available anywhere off the exchange.\footnote{157} And this is precisely what is observed, at least anecdotally.\footnote{158} Moreover, many of the concerns over standardization and commodification raised above, such as concerns over the loss of heirloom varieties or poor service,\footnote{159} are plainly not relevant to a contract exchange for simple financial products like CDs. In sum, MoneyAisle’s consumer contract exchange is a big win for consumers.

These consumer-to-business contract exchanges are useful and beneficial, but they are all relatively primitive. They offer only primary markets in unilateral contracts and make only limited use of valuable optional institutional attributes such as margin. Many more complex consumer-to-business contract exchanges can surely be conceived.

For example, a secondary market is possible. A consumer that contracted on Hotwire for a hotel room might wish to sell to another the contractual right to use the room.\footnote{160} Alternatively, the hotel might decide that it no longer wants to rent the room for the contracted-for price and would prefer to assign the contract to another (equivalent) hotel. Bilateral contracts are possible, probably in connection with margin requirements. Hotwire could allow consumers to enter into true bilateral contracts using a margin of, say, 50%, meaning they would pay half at the time of contracting and half at the time of performance.\footnote{161}

\begin{footnotes}
\item[156] Eisenberg, supra note 149 (noting that one “drawback[]” of MoneyAisle is that it asks “consumers to apply for a product online with a provider they don’t know”).
\item[157] See supra Section I.B.
\item[158] See Jenn Abelson, Point. Click. Bank. And Save., Bos. Globe, Feb. 8, 2009, at G1 (“During my own auction for a $10,000 high-yield savings account, 68 banks submitted 138 bids during 12 rounds. First Trade Union Bank offered a 3.25 percent rate, well above national and state averages.”); Eisenberg, supra note 149 (“I tried out MoneyAisle about three weeks ago, using the example of a six-month, $10,000 CD... I was offered 4.2 percent, well above the national average at the time of 3.15 percent.”). This author confirms similar results on various occasions, but is unaware of any rigorous empirical study on point.
\item[159] See supra Section I.B.
\item[160] Cf. Marvin A. Chirelstein, Concepts and Case Analysis in the Law of Contracts 182-84 (6th ed. 2010) (framing Krell v. Henry, 2 K.B. 740 (1903), as a case in which “Henry was ‘long’ a two-day lease on a flat in Pall Mall”; had the coronation gone forward as scheduled, Henry might have sold his lease in a secondary market).
\item[161] That would presumably be at time of check-out. See generally Coletti v. Knox Hat Co., 169 N.E. 648, 649 (N.Y. 1930) (“When the performance of a contract consists in doing (faciendo) on one side and in giving (dando) on the other side, the doing must take place before the giving.”).
\end{footnotes}
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All of these more complex forms are possible in theory, but as far as research reveals, none currently exist.\(^{162}\) This Article contends that their absence is due, at least in part, to the fact that contracts of adhesion are not reliably enforceable against consumers. This last point is explored more fully in Section III.B.

2. Consumer-to-Consumer Contract Exchanges

A consumer-to-consumer\(^{163}\) contract exchange is one where consumers make contracts with one another or trade those contracts on an organized exchange. This type of exchange has only appeared in the past few years, and only on the web; this is likely related to the recent widespread adoption of high-speed Internet service over the past few years.\(^{164}\)

a. eBay

eBay is a tremendously successful online bazaar where consumers make contracts with one another for the sale of goods, often in an auction format.\(^{165}\) To participate, one must register with an e-mail address and agree to eBay’s User Agreement and its Rules & Policies,\(^{166}\) which include standard contract terms to govern the contracts created on the site.\(^{167}\) The consumer-to-consumer contracts created on eBay are true bilateral contracts, as they contain promises of future performance on both sides: the buyer promises to pay, and the seller promises to ship the item.\(^{168}\) eBay profits by exacting a small toll on every transaction on its site; it does not itself buy or sell anything, nor is it a party to the contracts made.

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\(^{162}\) Hotwire’s standard form contract expressly forbids a secondary market. Hotwire Travel Products Rules and Restrictions, HOTWIRE, http://www.hotwire.com/about-hotwire/other-resources/hotwireAgreement.jsp (last visited Mar. 29, 2011) (“All bookings are final and cannot be changed, refunded, exchanged, cancelled, or transferred to another party.”).

\(^{163}\) The equivalent terms “peer-to-peer,” “person-to-person,” and “P2P” are sometimes used. E.g., Fara S. Sunderji, Protecting Online Auction Sites from the Contributory Trademark Liability Storm: A Legislative Solution to the Tiffany Inc. v. eBay Inc. Problem, 74 FORDHAM L. REV. 909, 913 n.33 (2005) (describing eBay as a “person-to-person” market).

\(^{164}\) AARON SMITH, PEW RESEARCH CTR.’S INTERNET & AM. L. PROJECT, HOME BROADBAND 2010, at 6 (2010), available at http://www.pewinternet.org/~/media/Files/Reports/2010/Home%20broadband%202010.pdf (reporting that the percentage of Americans with broadband Internet access grew from 16% in 2003 to 66% in 2010, based on survey data).

\(^{165}\) See Tiffany (NJ) Inc. v. eBay Inc., 600 F.3d 93, 96-97 (2d Cir. 2010) (describing eBay).

\(^{166}\) Tiffany (NJ) Inc. v. eBay Inc., 576 F. Supp. 2d 463, 476 (S.D.N.Y. 2008) (noting that eBay requires all users “to register with eBay and sign eBay’s User Agreement”).


So, is eBay a contract exchange? No. The first prerequisite of a contract exchange is the use of nonnegotiable standardized contracts for fungible subject matter.\textsuperscript{169} But the contracts between buyers and sellers on eBay are highly customizable and negotiable in any number of ways, such as the shipping method and forms of acceptable payment, and the underlying goods for sale are not uniform.\textsuperscript{170} In short, because contracts consummated on eBay are negotiable, not standardized, and because the underlying subject matter is variable, eBay is not a contract exchange.

That said, eBay does exhibit several of the institutional attributes of contract exchanges. First, eBay contracts are reliably enforceable. This is not to say that every eBay contract is performed—in fact, many are breached—but merely that courts will respect and endeavor to enforce them just as they would any ordinary contract.\textsuperscript{171} Second, eBay employs membership requirements to ameliorate counterparty risk. All participants are required to register with eBay before consummating any contracts and assign themselves a “screen name” so that their behavior in the eBay marketplace can be reviewed by other participants in a public “feedback score.”\textsuperscript{172} As a party with a low feedback score may find it hard to find anyone willing to deal with them, this provides an informal means of enforcing contracts and deterring breach. Third, the live auctions and goods for sale on eBay may be observed by anyone with a web browser; there is no need to register. By letting even nonmembers observe the bids, asks, and transaction prices in real time, eBay benefits the general public through price discovery.\textsuperscript{173} For example, someone seeking to hold a “garage sale” might rely on eBay to determine reasonable prices for household items.\textsuperscript{174}

In this way, an active, liquid market on eBay not only benefits direct participants but also is in the broader public interest. And eBay is certainly an active, liquid market—there are more than 90 million active traders on the site, and $2000 worth of goods are sold every second.\textsuperscript{175}

In sum, eBay is not truly a consumer contract exchange, but it does possess some of the key institutional attributes of such exchanges and yields some of their benefits.

\begin{itemize}
\item \textsuperscript{169} See supra Subsection I.A.1.a.
\item \textsuperscript{170} See Selling Practices Policy, EBAY, \url{http://pages.ebay.com/help/policies/selling-practices.html} (last visited Feb. 22, 2011) (requiring sellers to include such specifications in their listings); see also Dedvukaj v. Maloney, 447 F. Supp. 2d 813, 816-17 (E.D. Mich. 2006) (noting that seller required “international bidders to provide money orders using United States funds and to e-mail for shipping quotes”); Gossett v. HBL, LLC, No. 2:06-123-CWH, 2006 WL 1328757, at *4 (D.S.C. May 11, 2006) (explaining that the parties’ written Purchase Agreement modified the eBay contract for an expensive car).
\item \textsuperscript{171} See, e.g., Dedvukaj, 447 F. Supp. 2d at 816-17 (enforcing a contract consummated on eBay); Gossett, 2006 WL 1328757, at *7 (same); see also Invalid Bid Retraction Policy, supra note 168.
\item \textsuperscript{172} The score is depicted by a small graphical star whose color indicates the level of positive feedback a user has received.
\item \textsuperscript{173} See Epstein, supra note 91, at 816.
\item \textsuperscript{174} This benefit is equally available to the garage-sale shoppers, of course.
\item \textsuperscript{175} eBay: Who We Are, EBAY, \url{http://www.ebayinc.com/who} (last visited on Mar. 29, 2011).
\end{itemize}
b. Prosper

Prosper, founded in 2006, is "the largest peer-to-peer lending marketplace" in the world where consumers pool their money online to make small unsecured loans to one another.\textsuperscript{176} Prosper is open to anyone who wishes to lend and borrowers with a decent credit score.\textsuperscript{177} To date, more than one million consumers have joined Prosper, lending and borrowing more than $200 million.\textsuperscript{178}

At Prosper and other peer-to-peer lending markets,\textsuperscript{179} consumers can obtain loans directly from one another without going through a middleman.\textsuperscript{180} Prosper is, in a sense, a stripped-down form of banking. Conceptually, a bank borrows from a group of people at one rate and then, selectively and serially, lends back to that same group at a higher rate. Prosper aims to cut out the intermediary bank and allow people to lend directly to one another. Or, perhaps more accurately, Prosper's aim is not to destroy the intermediary, but rather to become it.\textsuperscript{181} It presently charges borrowers up to a 3% servicing fee, and lenders a 1% servicing fee. But this approximately 1% or 2% transaction cost is almost certainly a much tighter spread than is usual for traditional banks, which might pay depositors 3% and lend to them at 7%. In any event, despite Prosper's similarities to a bank, the Securities and Exchange Commission ("SEC") determined that the loans originated and traded on Prosper are securities and subject to SEC regulation.\textsuperscript{182}

To borrow money on Prosper, one creates an online listing that includes the amount and purpose of the loan and an optional photograph. In Prosper's original incarnation, borrowers would indicate their maximum rate and lenders would bid against one another to offer the lowest interest rate in an auction format. This auction format was discontinued in late 2010 and replaced with


\textsuperscript{177} Borrowers must meet the minimum credit score requirement of 640. Press Release, Prosper Marketplace Inc., Prosper's SEC Registration Declared Effective (July 13, 2009), available at http://www.prosper.com/about/media_press_releases.aspx?i=Prosper's_SEC_Registration_Declared_Effective. Nationally, credit scores range from 300-850, with a median of 723. Kenneth R. Harney, New Mortgages Worry Regulators, WASH. POST, June 10, 2006, at F3. Thus, a score of 640 indicates a borrower whose creditworthiness is well below average but far from the worst.

\textsuperscript{178} Company Overview, supra note 176.


\textsuperscript{180} Id.


interest rates set by Prosper based on the borrower’s financial status and credit history. 183 Lenders can put as little as $25 into a loan and, if enough of them invest to meet the full amount sought by the borrower (say, $2000), then the loan will fund and the borrower will make payments to each of the lenders over the life of the loan. 184 Apart from the amount and interest rate, all contractual terms—term of loan, choice of law, acceleration clause, and the like—are fixed in a standard form promissory note drafted by Prosper.

All of this is to say that Prosper is a consumer-to-consumer contract exchange that displays both of the required characteristics of all contract exchanges. First, the promissory notes on Prosper are all on the same standard form. 185 Second, the promissory notes have proven sufficiently reliably enforceable for the exchange to function. This is not to say that every loan on Prosper is repaid—in fact, the default rate is fairly high. 186 But this has nothing to do with the legal enforceability of the promissory notes; rather, it is a function of the precarious financial position of many Prosper borrowers. 187

Prosper bears many similarities to the consumer contract exchanges considered thus far. But Prosper has gone a step farther than the others by establishing a secondary market. This is a relatively new phenomenon, having been introduced in 2009. Up to that point, lenders were stuck for the full term of each loan with no way to sell or transfer them. This illiquidity was a frequent subject of lender complaints, 188 and finally, after Prosper registered with the SEC, a secondary market was established. This was only possible, as should be clear by now, because all of the loan agreements created on Prosper are standardized. The new secondary market has operated relatively well to date. Because there are so many lenders on Prosper, it is a highly competitive market. Thus, one should expect that borrowers are receiving all, or nearly all, 189
of the liquidity benefits of a secondary market in the form of lower interest rates.\textsuperscript{189}

As for the optional attributes of such exchanges, Prosper does not employ a clearinghouse or margin, which makes sense in the context of a lending market. The whole idea is that lenders are pricing the risk of each individual borrower. It does, however, have an important membership requirement: extremely risky borrowers with credit scores of under 640 may not participate. And, like eBay, Prosper provides the public with price discovery by allowing anyone to observe the active bids—though it reserves detailed credit information about borrowers for members only.

Separate from these public benefits, theory predicts that Prosper, as a contract exchange, should deliver significant benefits to the consumers that choose to participate.\textsuperscript{190} And empirical evidence bears this out: independent reports indicate that borrowers on Prosper receive better interest rates than are available from a bank or other financial institution,\textsuperscript{191} and that lenders receive a relatively attractive rate of return on their investments.\textsuperscript{192} Furthermore, Prosper has led to other benefits for participants, perhaps most notably a marked decrease in racial, gender, or other discrimination.\textsuperscript{193}

Prosper has democratizing aspirations and is specifically targeted at consumers whose alternative sources of lending might include ultra-high interest payday loans.\textsuperscript{194} By harnessing the power of the contract exchange, Prosper offers attractive interest rates to borrowers with checkered credit histories, thereby benefiting the most vulnerable members of society.

\textsuperscript{189.} An empirical assessment of this claim would be difficult. One could compare interest rates paid before and after the introduction of the secondary market. However, the former group of loans were all made before the recent financial crisis, and the latter group were all made after, so the comparison could easily be tainted by a significant change in risk aversion from one historical period to another.

\textsuperscript{190.} See supra Section I.B.


\textsuperscript{192.} Lender returns vary greatly from lender to lender. The mean is about 2%, which may compare favorably with common stocks, at least at present. Compare Prosper.com Lender Return Distribution, ERIC'S CREDIT COMMUNITY, http://www.ericsec.com/stats/lender-return-distribution (last visited Feb. 22, 2011), with Tom Lauricella, Investors Hope the '00s Beat the '00s, WALL ST. J., Dec. 21, 2009, at C1 (noting that in the decade from 2000-2009, “stocks traded on the New York Stock Exchange have lost an average of 0.5% a year”).

\textsuperscript{193.} Michal Herzenstein et al., The Democratization of Personal Consumer Loans? Determinants of Success in Online Peer-to-Peer Lending Communities, at 32 (Feb. 2008) (unpublished manuscript), available at http://www.rice.edu/nationalmedia/multimedia/online (noting that there is “less discrimination and more democratization in P2P lending communities when compared with institutional lending”); cf. Peter Steiner, Cartoon, THE NEW YORKER, July 5, 1993, at 61 (“On the Internet, nobody knows you're a dog.”).

\textsuperscript{194.} Prosper encourages researchers and academics to use its data and share their conclusions publicly, and several academic papers have been posted on the Prosper website itself. See Academics & Research, PROSPER, http://www.prosper.com/about/academics.aspx (last visited Mar. 29, 2011) (“One of our primary objectives in making Prosper market data fully transparent and freely available is to permit and encourage anyone to study the Prosper market.”).
Ironically, as shall be seen in Part III, the adhesion doctrine—that friend of the consumer—may threaten Prosper's very existence.

II. Contracts of Adhesion

A. Definition

A "contract of adhesion," in the parlance of contract law, is a take-it-or-leave-it standard form agreement, usually presented to a consumer by a business entity. Negotiation over any of the terms contained in the form—except, often, the price—is neither contemplated nor permitted. The "adherent" is given the mere choice to accept the terms or abandon the transaction entirely. The terms of an adhesion contract are commonly drafted by the stronger party to the transaction, but there are instances where the terms are proffered by a third party and both contracting parties are reduced to the humble role of adherent. The bottom line is that a "contract of adhesion" refers to the combination of two elements: (1) standard form; and (2) nonnegotiability.

A familiar example of a contract of adhesion is the Google Terms of Service, which govern the use of Google's websites, such as Google search, Gmail, or YouTube. The Terms of Service represent a contract whereby Google provides services to the user "in consideration for" allowing Google to

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195. Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 600 (1991); BLACK'S LAW DICTIONARY 366 (9th ed. 2009) ("A standard-form contract prepared by one party, to be signed by another party in a weaker position . . . who adheres to the contract with little choice about the terms."). See generally Rakoff, supra note 34, at 1176 ("The term 'contract of adhesion' has acquired many significations and therefore needs definition."). For some of the earliest uses of the phrase, see Kessler, supra note 14; and Edwin W. Patterson, The Delivery of a Life-Insurance Policy, 33 HARV. L. REV. 198, 222 (1919).

196. This Article uses the term "negotiated contract" as an antonym for "contract of adhesion." It also refers to the weaker party to a contract of adhesion as the "adherent." See, e.g., Daniel D. Barnhizer, Inequality of Bargaining Power, 76 U. COLO. L. REV. 139, 172 (2005); Albert A. Ehrenzweig, Adhesion Contracts in the Conflict of Laws, 53 COLUM. L. REV. 1072, 1077 (1953) (using the term "adherent," perhaps for the first time).

197. E.g., Graham v. Scissor-Tail, Inc., 623 P.2d 165, 171-72 (Cal. 1981) (discussing an adhesive "Form B" contract between musical group and concert promoter was drafted and imposed by musicians' union); Alvin C. Harrell, Basic Choices in the Law of Auto Finance: Contract Versus Regulation, 7 CHAP. L. REV. 107, 127 (2004) (noting that in the used car market, the standard retail installment sales contract between a dealer and a consumer "is a standard-form adhesion contract . . . for the dealer as well as the consumer").

198. Graham, 623 P.2d at 171; Rudbart v. N. Jersey Dist. Water Supply Comm'n, 605 A.2d 681, 686 (N.J. 1992) (citing Rakoff, supra note 34, at 1230); Taylor Bldg. Corp. of Am. v. Benfield, 884 N.E.2d 12, 24 (Ohio 2008); cf. Rakoff, supra note 34, at 1177 (offering a list of seven characteristics that define a "model" contract of adhesion, but clarifying that the seven characteristics are simply the same two-element definition "[m]ore precisely spelled out").


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“place . . . advertising on the Services.”200 And this contract is clearly nonnegotiable, as it states on its face, “In order to use [any of Google’s] Services, you must first agree to the Terms. You may not use the Services if you do not accept the Terms.”201 No deviations will be permitted, no negotiations will be held. Take it or leave it.

From the perspective of contract law, this is problematic. A key normative premise of the enforcement of contracts is that the legal obligation being enforced was accepted knowingly and voluntarily (and for consideration),202 hence the law has always refused to enforce contracts tainted by duress, fraud, or incapacity.203 But contracts of adhesion—which feature unequal bargaining power and no negotiation—represent the opposite of that paradigmatic agreement.204 The process of adhesion contracting “is not one of haggle or cooperative process, but rather of a fly and flypaper,”205 so adherents cannot really be said to have voluntarily assented to the terms of that flypaper.206 And without assent, contracts of adhesion are not really “contracts” as traditionally understood207 and therefore not necessarily subject to the ordinary law of contracts as it has developed over the ages.208 The fact that a contract is

200. Google Terms of Service, supra note 199, ¶ 17.3; id. ¶ 2.3(a) (requiring that users be “of legal age to form a binding contract with Google”); see Karl T. Muth, Googlestroika: Privatizing Privacy, 47 DUQ. L. REV. 337, 340 (2009) (noting that “anyone who has ever used Google has assented to Google’s Terms of Service contract”). See generally RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981) (“[T]he formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.”).


202. RESTATEMENT (SECOND) OF CONTRACTS §§ 3, 74, 174-177 (1981); 1 FARNSWORTH, supra note 7, § 3.1; Rakoff, supra note 34, at 1180 (explaining that “contract law is rationalized in large part on the voluntary assumption of obligation”); W. David Slawson, Mass Contracts: Legal Fraud in California, 48 S. CAL. L. REV. 1, 13 (1974) (noting that “the traditional law of contract characterizes as a contract only that to which both parties have given their ‘assent’” because “[i]n a free society no one is held to duties he has not, in some way, had the opportunity to give or withhold consent”).


206. E.g., Williams v. First Gov’t Morg. & Investors Corp., 225 F.3d 738, 748 (D.C. Cir. 2000) (“When a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms.”); Leff, supra note 205, at 143; Amy J. Schmitz, Embracing Unconscionability’s Safety Net Function, 58 ALA. L. REV. 73, 92 (2006) (noting that contracts of adhesion undermine “classical will theory of promise enforcement” as they lack “true consent”); W. David Slawson, The New Meaning of Contract: The Transformation of Contracts Law by Standard Forms, 46 U. PITT. L. REV. 21, 33-35 (1984) (explaining that “lack of assent is the problem” with adhesion contracts).


208. E.g., Rudbart v. N. Jersey Dist. Water Supply Comm’n, 605 A.2d 681, 686 (N.J. 1992) (noting the “distinct body of law surrounding contracts of adhesion”); Rakoff, supra note 34, at 1174-75
adhesive is seen as evidence of such a severe imbalance of bargaining power as to require some “judicial meddling” with the contract to protect the weaker party.209

It bears noting that the concept of adhesion pertains only to consumer contracts, at least as a practical matter.210 True, the literal definition of a contract of adhesion—a nonnegotiable standard form agreement—says nothing about sophistication or bargaining power.211 And, from time to time, a court will declare a commercial contract between sophisticated parties to be adhesive.212 After all, Google’s Terms of Service constitute a contract of adhesion for all users, even wealthy and powerful computer experts like Bill Gates, who is surely a sophisticated party with ample bargaining power.213 But these are exceptional cases and Holmes is still quite right that “a page of history is worth a volume of logic.”214 In theory, the concept of adhesion can be

209. JLM Indus., Inc. v. Stolt-Nielsen SA, 387 F.3d 163, 169 (2d Cir. 2004) (explaining that a contract of adhesion “is a contract formed as a product of a gross inequality of bargaining power between parties”).

210. Arthur Allen Leff, Unconscionability and the Code—The Emperor’s New Clause, 115 U. PA. L. REV. 485, 553 (1967). In other words, the legal disfavor for contracts of adhesion stems ultimately from the assumption that nonnegotiabilty and unequal bargaining power go hand-in-hand. But as we shall see in Part III, infra, this is not necessarily so. Rather, parties with perfectly balanced bargaining power have good reasons for using nonnegotiable standard forms. Consider two sophisticated traders that consummate a futures contract on a futures exchange. Their bargaining power is approximately equal. Even so, the parties’ agreement is contained in a standard form drafted by the exchange that the parties are powerless to change. So the fact that a contract is adhesive is not always conclusive evidence of an inequality of bargaining power.


212. 1 FARNSWORTH, supra note 7, § 4.26 n.5.

213. E.g., G-I Holdings, Inc. v. Reliance Ins. Co., 586 F.3d 247, 254 (3d Cir. 2009); Nagrampa v. MailCoup, Inc., 469 F.3d 1257, 1265, 1309 (9th Cir. 2006) (en banc) (finding franchise agreement involving hundreds of thousands of dollars to be a contract of adhesion); Graham v. Scissor-Tail, Inc., 623 P.2d 165, 171-72 (Cal. 1981) (noting that prominent and successful music promoter succeeded in showing that he was “reduced to the humble role of ‘adherent’”); Rakoff, supra note 34, at 1178, 1253 n.252 (collecting cases).

214. And the usual roles can surely be reversed, as in a parking contract between Bill Gates and the operator of a small parking garage in Midtown Manhattan. In such a circumstance, Gates, despite his power and prestige, plays the role of adherent to the garage’s standard parking agreement. 1 FARNSWORTH, supra note 7, § 4.26 n.5.

applied to anyone, regardless of social or economic rank, but in practice, wealthy or sophisticated parties are almost never treated as adherents.\footnote{216} Moreover, a regular feature of business or employment negotiation is the use of a standard form contract as a basis for negotiations (a “jumping off point”). Many organizations, including the American Bar Association,\footnote{217} the American Institute of Architects,\footnote{218} and the International Swap Dealers Association publish form contracts for this purpose.\footnote{219} But the resulting contract in such cases is a product of negotiation\footnote{220} and therefore not a contract of adhesion. In short, the concept of adhesion is, for most practical purposes, confined to the consumer context; business entities and sophisticated parties cannot avail themselves of it.

Because much of the concern over contracts of adhesion arises from a perceived imbalance of bargaining power, some may question whether there can be a contract of adhesion when the purported adherent has a meaningful alternative source of the good or service. One could, for example, conduct web searches on Yahoo! instead of Google. Does that competition in the marketplace render the Google Terms of Service nonadhesive? Courts and scholars are split on the issue,\footnote{221} but the fact is that many courts routinely declare contracts in obviously competitive industries—such as cell phone

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216. \textit{E.g.}, Lanier at McEver, L.P. v. Planners & Eng'rs Collaborative, Inc., 663 S.E.2d 240, 247 (Ga. 2008) (holding that contract between two sophisticated entities on equal footing was not a contract of adhesion); Torgerson v. One Lincoln Tower, LLC, 210 P.3d 318, 321, 324 (Wash. 2009) (holding that contract between “trained, licensed real estate agents” and development company to purchase condominiums was not adhesive). \textit{See generally} Adler & Silverstein, supra note 211, at 48 (“[P]ersons of greater sophistication suffer less contractual abuse and need less protection.”).

217. \textit{E.g.}, Franci J. Blassberg, \textit{Asset Purchase Agreement, in CORPORATE MERGERS AND ACQUISITIONS} 139 (ALL-ABA Continuing Legal Educ., Coursebook Ser. No. SP031, 2008).

218. \textit{E.g.}, JOSEPH A. DEMKIN, \textit{THE ARCHITECT'S HANDBOOK OF PROFESSIONAL PRACTICE} 777 (2001) (“T[he words ‘Standard Form’ ... [are] not meant to imply that a uniform set of contractual requirements is mandatory ... . Rather, AIA standard documents are intended to be used as fair and balanced baselines from which the parties can negotiate their bargains.”).


220. \textit{See, e.g.}, Liam Denning, \textit{Heard on the Street: Don't Be Negligent About Andarko}, WALL ST. J., June 15, 2010, at C10 (noting that “the standard template for deep-water [oil drilling] agreements—the American Association of Professional Landmen’s Form 810”—is generally modified to include “specific language” negotiated between the parties).

221. \textit{Compare} Shroyer v. New Cingular Wireless Servs., Inc., 498 F.3d 976, 985 (9th Cir. 2007) (holding that a contract may be adhesive “even if the customer has a meaningful choice as to service providers”) (internal quotation marks omitted), and Nagrampa v. MailCoup, Inc., 469 F.3d 1257, 1283 (9th Cir. 2006), and Rakoff, supra note 34, at 1178-79, with Clinic Masters v. Dist. Ct., 556 P.2d 473, 475-76 (Colo. 1976), and Wallace v. Nat'l Bank of Commerce, 938 S.W.2d 684, 687-88 (Tenn. 1996) (a contract is adhesive only if adherent shows that equivalent “services could not be obtained elsewhere”), and Albuquerque Tire Co., Inc. v. Mountain States Tel. & Tel. Co., 697 P.2d 128, 131 (N.M. 1985).
service, car rentals, or vacation cruises—to be adhesive, thereby demonstrating that market power is not a prerequisite to a finding of adhesion.\textsuperscript{222} That said, it is generally agreed that a contract of adhesion drafted by a monopolist, or where an entire industry has adopted the same form, is “particularly onerous” because the adherent has “no alternatives but to enter into the contract.”\textsuperscript{223}

Finally, it is a commonplace that practically no one reads, let alone understands, the car rental, credit card, cellular telephone, and other contracts of adhesion to which they assent.\textsuperscript{224} In part, this is because the agreements are frequently drafted in “legalese,” “fine print,” or “boilerplate”—that is, in terms incomprehensible to the average consumer.\textsuperscript{225} But this is a red herring, for even if the language were crystal clear, and even if every adherent read every term, it would change nothing.\textsuperscript{226} An adherent would still be stuck with the mere choice to adhere or walk away.\textsuperscript{227} The Google Terms of Service is written in fairly readable prose,\textsuperscript{228} so that a user realistically could sit down and read and understand the terms offered by Google. But what difference would that make? Any adherent who wants to use Google must accept its terms. The best an adherent can do is hope that the Terms include only reasonable and decent terms,\textsuperscript{229} or that, in the event of a dispute, Google will decline, in the name of customer relations, to enforce the contract.\textsuperscript{230}

\textsuperscript{222} E.g., Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 595 (1991) (holding that cruise ticket is adhesive); Shroyer, 498 F.3d at 983-84 (holding that cellular telephone service contract is adhesive); Scott v. Cingular Wireless, 161 P.3d 1000, 1003 (Wash. 2007) (same); see also Phila. Indem. Ins. Co. v. Barerra, 21 P.3d 395, 402, 404 (Ariz. 2001) (holding that car rental agreement is adhesive).


\textsuperscript{224} Hillman, supra note 30, at 13 (1981) (“Consumers generally do not read their forms and, if they did, they would not understand them.”); Rakoff, supra note 34, at 1179; Jean R. Sternlight, Creeping Mandatory Arbitration: Is It Just?, 57 STAN. L. REV. 1631, 1648 (2005) (“Empirical studies have shown that only a minute percentage of consumers read form agreements, and of these, only a smaller number understand what they read.”).

\textsuperscript{225} E.g., Margaret Jane Radin, Humans, Computers and Binding Commitments, 75 IND. L.J. 1125, 1153, 1160 (2000); see Joshua Fairfield, The Cost of Consent: Optimal Standardization in the Law of Contract, 58 EMORY L.J. 1401, 1406-09 (2009). But see id. at 1431-45 (defending standardized contracts as reducing transaction costs for all concerned).

\textsuperscript{226} Rakoff, supra note 34, at 1179-80; see, e.g., Graham v. Scissor-Tail, Inc., 623 P.2d 165, 172-73 (Cal. 1981) (finding a contract of adhesion where the sophisticated adherent was very familiar with the term at issue before signing).

\textsuperscript{227} See, e.g., Google Terms of Service, supra note 199, ¶ 1.1 (“Your use of Google’s products, software, services and web sites . . . is subject to the terms of a legal agreement between you and Google . . . . This document explains how the agreement is made up, and sets out some of the terms of that agreement.”).

\textsuperscript{228} Cf. KARL LLEWELLYN, THE COMMON LAW TRADITION 370 (1960) (explaining that a party to a contract of adhesion gives its “blanket assent . . . to any not unreasonable or indecent terms the seller may have on his form”).

B. Scholarly Critiques

Many, if not most, contracts scholars take a dim view of contracts of adhesion, and the term itself has acquired a strongly negative connotation. The basic critique is premised on the idea that voluntary assent is a prerequisite to contractual enforceability—the law has always refused to enforce contracts tainted by duress, fraud, or incapacity—and mere submission to a set of terms one did not choose and cannot change does not constitute voluntary assent. Hence, many scholars take the view that the lack of voluntary assent renders contracts of adhesion less entitled than negotiated contracts to legal enforcement.

Beyond the problem of lack of assent, scholars have also railed against contracts of adhesion on other grounds. Todd Rakoff has warned that the use of adhesion contracts forces consumers to "submit to organizational domination, leavened by the ability to choose the organization by which [one] will be dominated." And David Slawson has expressed concern that widely used contracts of adhesion constitute an act of undemocratic lawmaking by powerful business interests. In these scholars' view, consumer contracts should be governed by the default rules of contract law, which are ultimately accountable to the democratic process, rather than the rules drafted by, and in favor of, the stronger party.

Contracts of adhesion also have their scholarly defenders. In the mid-twentieth century, Karl Llewellyn espoused his view that one who signs a contract of adhesion does "in fact" assent not only to "the few dickered terms, and the broad type of the transaction," "but one thing more." In Llewellyn's view, the adherent also gives a "blanket assent" to the "not unreasonable or...
indecent terms the seller may have on his form, which do not alter or eviscerate the reasonable meaning of the dickered terms.237 In other words, "unreasonable or indecent" terms should not be enforced by the courts. This view "dominates contemporary judicial treatment of standard-form provisions."238

There have been attempts by law and economics scholars, such as Alan Schwartz, Louis Wilde, and Richard Epstein, to demonstrate that market competition will lead to terms that are acceptable to, if not fully optimal for, most adherents.239 Under such conditions, "judicial meddling" in contracts of adhesion can have the perverse effect of harming the very people it is intended to assist by, for instance, driving up the cost of consumer credit.240 This argument from law and economics certainly has force, but critics of adhesion contracts have struck back with behavioral law and economics. Because consumers are "boundedly rational rather than fully rational decisionmakers," contend the behavioralists, the standard law and economics theory does not apply to the real world and should therefore be rejected.241

In the end, these dueling law-and-economic analyses have more or less fought to a tie.242 Richard Posner and others have recently attempted to break the tie by arguing that businesses concerned with their reputation will, thanks to customer and public relations concerns, be reluctant to enforce harsh contractual terms to the letter.243 But the idea that consumers should rely on the munificence of businesses as protection against legally enforceable harsh terms provides very little comfort to consumer advocates, for in such cases, "[t]he discretion of the organization has taken the place of rights enforceable by law."244 So the mainstream scholarly view remains that contracts of adhesion

237. LLEWELLYN, supra note 229, at 370; see Slawson, supra note 206, at 34.
239. Richard A. Epstein, Behavioral Economics: Human Errors and Market Corrections, 73 U. CHI. L. REV. 111, 127 (2006); Korobkin, supra note 231, at 1206 ("[I]f buyers and sellers behave in accordance with assumptions of rational choice theory, the operation of the market usually will provide drafting parties with an incentive to include only efficient terms in form contracts."); Alan Schwartz & Louis L. Wilde, Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis, 127 U. PA. L. REV. 630, 638 (1979); see RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.9, at 116 (7th ed. 2007).
240. POSNER, supra note 239, § 4.9, at 117; Leff, supra note 210, at 558-59.
242. See David Horton, Flipping the Script: Contra Proferentem and Standard Form Contracts, 80 U. COLO. L. REV. 431, 469 (2009) ("This debate is not likely to end soon.").
244. Rakoff, supra note 34, at 1228.
are bad, especially for consumers, and many academics think the law ought not to enforce them.245

This academic position, however, has never been adopted as law,246 for all agree that contracts of adhesion provide consumers one major benefit that outweighs the many detriments of such one-sided forms: they greatly reduce the cost of contracting.247 There are many variations on the theme, but the essential idea is that just as standardization and mass production can reduce the cost of producing and distributing goods and services,248 so too can standardization and mass production reduce the cost of contracting for goods and services.249 And these savings may be passed along to the weaker party in the form of a lower price (or interest rate).250

This benefit of standardized contracts of adhesion is both great and widely appreciated.251 Llewellyn recognized it early on and became a lifelong supporter of the general enforceability of contracts of adhesion.252 Many other scholars have followed him, offering careful elaborations on the variety of ways in which contracts of adhesion reduce transaction costs,253 and many courts have accepted this line of thinking.254

245. Barnett, supra note 231, at 627 ("I would wager that a plurality of contracts teachers would favor a judicial refusal to enforce form contracts altogether."); see sources cited supra note 230.
246. Barnett, supra note 231, at 638-39; Rakoff, supra note 211, at 1235 (acknowledging that the rule of presumptive unenforceability he proposed in Rakoff, supra note 34, "was not then, and is not now, the law").
249. E.g., Wis. Auto Title Loans, Inc. v. Jones, 714 N.W.2d 155, 170 & n.48 (Wis. 2006); RESTATEMENT (SECOND) OF CONTRACTS § 211 cmt. a (1979); 1 FARNSWORTH, supra note 7, § 4.26 ("As with goods, standardization and mass production of contracts may serve the interests of both parties."); Kaustuv M. Das, Forum-Selection Clauses in Consumer Clickwrap and Browsewrap Agreements and the "Reasonably Communicated" Test, 77 WASH. L. REV. 481, 485-86 (2002) ("[T]he advantages of standardization would be lost if customers haggled over or sought legal counsel regarding standard terms.").
251. See sources cited supra note 247.
252. Llewellyn, supra note 247, at 701; see Rakoff, supra note 34, at 1198-1206 (recounting Llewellyn's works and views). But cf. id. at 1201 (suggesting that Llewellyn's view might have been "a strategic compromise").
254. See sources cited supra note 247.
Critics of adhesive contracts have persuasively responded, however, that the transaction-cost savings generated by contracts of adhesion need not be shared with the consumer. Rather, they can be—and, given the fiduciary duties that corporate managers owe to shareholders, generally will be—retained by the business.\textsuperscript{255} Of course, in competitive markets, some or all of the cost savings will likely be returned to the consumer.\textsuperscript{256} In reality, however, many companies, ranging from Facebook to Con Edison, have monopolistic market power,\textsuperscript{257} so that transaction-cost analysis has not been enough to impress the critics of contracts of adhesion,\textsuperscript{258} many of whom continue to advocate the presumptive, if not total, unenforceability of contracts of adhesion.\textsuperscript{259}

\section*{C. \textit{Current Doctrine}}

The costs of adhesion contracts are great, but their efficiency benefits are so compelling that the courts have never adopted a flat rule against enforcing them, despite the scholarly support for such a rule.\textsuperscript{260} Rather, the common law has adopted an intermediate position: when confronted with a contract of adhesion, the court must conduct a substantive review of its terms and, if it finds any such terms (or the agreement as a whole) to be “harsh or overly one-sided,” it has the power to refuse enforcement in whole or part.\textsuperscript{261}

This rule is derived from the equitable unconscionability doctrine, which holds that while courts must generally enforce any contracts private parties

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E.g., Fairfield, supra note 225, at 1409 (“Unless there is a reason not to do so, companies will quite rationally pocket the savings.”); Schmitz, supra note 206, at 106 (noting lack of “empirical proof” that “merchants pass cost of one-sided form contracts on to consumers”); cf. Jean R. Sternlight & Elizabeth J. Jensen, \textit{Using Arbitration To Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse?}, 67 LAW \& CONTEMP. PROBS. 75, 95 (2004) (“[N]o published studies show that the imposition of mandatory arbitration leads to lower prices.”).
\item[\textsuperscript{256}]
IFC Credit Corp. v. United Bus. & Indus. Fed. Credit Union, 512 F.3d 989, 993 (7th Cir. 2008) (“As long as the market is competitive, sellers must adopt terms that buyers find acceptable; onerous terms just lead to lower prices.”); Stephen J. Ware, \textit{The Case for Enforcing Adhesive Arbitration Agreements— with Particular Consideration of Class Actions and Arbitration Fees}, 5 J. AM. ARB. 251, 255-56 (2006) (noting that “the entire cost-savings is passed on to consumers only under conditions of perfect competition,” and some savings may pass on even in its absence).
\item[\textsuperscript{257}]
This is not necessarily illegal or improper. The markets for branded goods or patented pharmaceuticals are inherently monopolistic but apparently do not violate the antitrust laws.
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See, e.g., Rakoff, supra note 34, at 1176 (noting that “the form terms present in contracts of adhesion ought to be considered presumptively (although not absolutely) unenforceable”); Slawson, supra note 231, at 549-53 (advocating “the total nonenforcement of adhesive contracts” unless “the power that coerces the adhesive contract is legitimate,” that is, democratically derived).
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See sources cited supra note 246.
\item[\textsuperscript{261}]
Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 595 (1991) (“[F]orm . . . contracts are subject to judicial scrutiny for fundamental fairness.”); Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449-50 (D.C. Cir. 1965) (explaining that when a contract is adhesive, “the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld”).
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choose to make, they should refuse to enforce an "unconscionable" contract or clause.\textsuperscript{262} Unconscionability is probably an appropriate safety valve to deal with bargains that shock the conscience, but it is also an "unruly horse" that could have the effect of injecting a post-hoc judicial review into every contract.\textsuperscript{263} To avoid that unfortunate outcome, the common law has implemented a two-part test requiring a party to establish both "procedural" and "substantive" unconscionability to succeed on such a claim.\textsuperscript{264} The procedural aspect refers to the manner of bargaining and making the contract; the substantive aspect refers to the bargain actually made. The result is that if a court finds "bargaining naughtiness" that amounts to procedural unconscionability, it will abandon the usual rule of freedom of contract and engage in a substantive review of the terms and bargain as a whole to ensure that it is fundamentally fair.\textsuperscript{265}

As for contracts of adhesion, most courts view them as ipso facto (if not per se) procedurally unconscionable.\textsuperscript{266} This has the important effect of always subjecting contracts of adhesion to the test for substantive unconscionability, that is, a substantive review for "fundamental fairness."\textsuperscript{267}

This "clause-by-clause policing" of contracts of adhesion can be expected to render them less reliably enforceable than negotiated agreements.\textsuperscript{268} This is

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\item \textsuperscript{262} I Farnsworth, supra note 7, § 4.28, at 554.
\item \textsuperscript{263} Jeffrey Stempel, \textit{Arbitration, Unconscionability, and Equilibrium: The Return of Unconscionability Analysis as a Counterweight to Arbitration Formalism}, 19 OHIO ST. J. ON DISP. RESOL. 757, 763 (2004) ("[M]any scholars have suggested that unconscionability is too plastic a concept that permits too much post-hoc judicial meddling with contracts.").
\item \textsuperscript{264} Schmitz, supra note 250, at 75. This bifurcated analysis has its origin in Leff, supra note 210, at 487. A few jurisdictions, namely Arizona and Washington, allow a claim of unconscionability to be premised on substantive unconscionability alone. See Luna v. Household Fin. Corp. III, 236 F. Supp. 2d 1166, 1174 (W.D. Wash. 2002); Maxwell v. Fidelity Fin. Servs., Inc., 907 P.2d 51, 58-60 (Ariz. 1995). And Mississippi appears to allow the same if procedural unconscionability alone is shown. See Banc One Acceptance Corp. v. Hill, 367 F.3d 426, 433 & n.4 (5th Cir. 2004). But these jurisdictions are outliers. Strand v. U.S. Bank Nat'l Ass'n ND, 693 N.W.2d 918, 921-24 (N.D. 2005) (noting that the "majority of courts... have held that a showing of some measure of both procedural and substantive unconscionability is required"); John E. Murray, Jr., \textit{An Effective Article 2 of the Uniform Commercial Code: Who Is Responsible?}, 11 DUQ. BUS. L.J. 123, 127 (2009) (noting that the "conventional wisdom" requires both).
\item \textsuperscript{265} Leff, supra note 210, at 487.
\item \textsuperscript{266} See, e.g., Edwards v. HOVENSA, LLC, 497 F.3d 355, 362 (3d Cir. 2007) (quoting Alexander v. Anthony Int'l, L.P., 341 F.3d 256, 265 (3d Cir. 2003)); Circuit City Stores v. Adams, 279 F.3d 889, 893 (9th Cir. 2002); Gentry v. Superior Ct., 165 P.3d 556, 572 (Cal. 2007); Muhammad v. Cnty. Bank, 912 A.2d 88, 96 (N.J. 2006); D.R. Horton, Inc. v. Green, 96 P.3d 1159, 1162 (Nev. 2004); Murray, supra note 264, at 127; White & Mansfield, supra note 233, at 263 ("[C]ourts ought to treat the procedural unconscionability prong as more or less established in any classic consumer contract of adhesion."); Contra Zuver v. AirTouch Comms., Inc., 103 P.2d 753, 760-61 (Wash. 2004) (holding that "the fact that an agreement is an adhesion contract does not necessarily render it procedurally unconscionable" if the alleged adherent "had a meaningful choice to sign the agreement."); Powertel, Inc. v. Bexley, 743 So. 2d 570, 574 (Fla. App. 1999) (noting that adhesion is "significant" but "not dispositive" on the issue of procedural unconscionability).
\item \textsuperscript{267} E.g., Armendariz v. Found. Health Psychcare Servs., Inc., 6 P.3d 669, 766-68 (Cal. 2000).
\item \textsuperscript{268} Leff, supra note 210, at 504, 553.
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because the terms of most negotiated agreements are enforced without any review at all, while the terms of contracts of adhesion are subject to a substantive review for fairness, and the application of a higher or stricter standard of review results in more frequent reversals or rejections. In civil procedure, a lower court ruling is much more likely to be reversed under a de novo standard than if reviewed for clear error or abuse of discretion, in constitutional law, a statute is much more likely to be invalidated when subject to strict scrutiny than a rational basis test; and in corporate law, a business decision is much more likely to lead to liability under an "entire fairness" test than under "business judgment" review. So too in contract law: a clause, or an entire contract, is much more likely to be refused legal enforcement under a fairness review than under no review at all. Hence, imposing a fairness review on contracts of adhesion should, as a matter of theory, lead courts to refuse to enforce terms in contracts of adhesion more frequently than in negotiated agreements, thus rendering contracts of adhesion less reliably enforceable than their negotiated counterparts.

This theoretical prediction is borne out in practice. Courts regularly refuse to enforce contracts of adhesion, in whole or part, under the fairness standard. One recent empirical study found that parties claiming a contract of adhesion to be unconscionable were successful an impressive 43% of the time. This result may be high, and many victories likely pertain to a single, perhaps severable, clause. But there can be little doubt that the fairness

270. News-Press v. U.S. Dep't of Homeland Sec., 489 F.3d 1173, 1187 (11th Cir. 2007) ("In even moderately close, cases, the standard of review may be dispositive of an appellate court's decision.").
271. See Kahawaiolaa v. Norton, 386 F.3d 1271, 1278 (9th Cir. 2004) ("The conclusion of whether a governmental act is subject to strict scrutiny or rational basis examination is important, as it often determines the outcome of the inquiry.").
272. See Emerald Partners v. Berlin, 787 A.2d 85, 89 (Del. 2001) ("When shareholders challenge actions by a board of directors, generally one of three standards of judicial review is applied: the traditional business judgment rule, an intermediate standard of enhanced judicial scrutiny, or the entire fairness analysis. The applicable standard of judicial review often controls the outcome of the litigation on the merits.").
273. See generally Klos v. Lotnicz, 133 F.3d 164, 168 (2d Cir. 1997) ("The concept of adhesion contracts introduces the serpent of uncertainty into the Eden of contract enforcement.").
276. The validity of this result may be questioned on the ground that only a few contract of adhesion cases are ever litigated.
277. Many cases pertain to arbitration clauses. See, e.g., Leonard v. Terminix Int'l Co., 854 So. 2d 529, 539 (Ala. 2002) (holding that the arbitration clause in the adhesive termite inspection contract was unconscionable); Muhammad v. Cnty. Bank, 912 A.2d 88, 103 (N.J. 2006) (holding that the provision waiving class-wide arbitration in an adhesive contract was unconscionable, unenforceable,
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review renders contracts of adhesion less reliably enforceable than negotiated agreements, all else being equal.

In short, thanks to the interplay between adhesive contracts and the unconscionability doctrine, contracts of adhesion are not reliably enforceable under current law, especially when the adherent is a consumer. And, as shall be seen in the final Part, this poses a significant problem for consumer contract exchanges.

III. Consumer Contract Exchanges and the Problem of Adhesion

The legal treatment of contracts of adhesion presents a paradox for all contract exchanges. In order to function, a contract exchange requires a legal system that reliably enforces nonnegotiable standard form contracts.278 Yet mainstream common law doctrine holds that nonnegotiable standard form contracts—that is, contracts of adhesion—are subject to a substantive fairness review and thus not reliably enforceable.279 This presents a fundamental problem for contract exchanges, one that threatens their very ability to function.

Fortunately, in the context of traditional contract exchanges, like CBOT, numerous federal appellate and state supreme courts have recognized and resolved this problem. These courts have held that although contracts traded on a contract exchange (or secondary) market “unquestionably fit” the “literal definition” of contracts of adhesion, they must nonetheless be reliably enforced as if they were ordinary contracts so that the exchange or secondary market can function.280 Thus, in the context of traditional contract exchanges, the threat posed by the adhesion doctrine has been neutralized.281

But the threat to consumer contract exchanges remains. The contracts on Prosper or Hotwire surely look adhesive—consumers that wish to participate have no choice but to click “I Agree” to the websites’ nonnegotiable standard forms. And the adherents to such contracts are unsophisticated consumers, not professional traders as in the case of traditional exchanges. Research has not revealed any case addressing whether consumer contracts that originate on a contract exchange should be treated as contracts of adhesion and therefore subject to review for substantive fairness. It is thus unclear whether a court presented with a contract that originated on a consumer contract exchange would treat it as a contract of adhesion (and thereby render the exchange

and severable); Fiser v. Dell Computer Corp., 188 P.3d 1215, 1217-22 (N.M. 2008) (holding that the arbitration clause in adhesive computer purchase contract was unconscionable).

278. See supra Subsection I.A.1.

279. See supra Section II.C.


281. See infra Section III.A.
inoperable), or whether it would extend the case law enforcing traditional exchange-traded contracts as if they were negotiated agreements to the consumer context.

This uncertainty in the law has had the negative effect of stunting the growth of consumer contract exchanges. In each of the consumer-to-business examples considered in Subsection I.C.1, the consumer must make full upfront payment at the time of contracting. This shows that Hotwire and the others have little confidence that a contract with a consumer can be reliably enforced. If consumers could be strictly held to their promises, perhaps Hotwire would allow consumers to pay in installments—say, half of the purchase price at the time of contracting and half at the time of performance. At least some consumers would prefer this option and would presumably be willing to pay a higher overall price.282

Furthermore, the contracts created and traded on consumer contract exchanges are quite small and insignificant to the broader economy. For example, the maximum loan available on Prosper is just $25,000—and the $200 million in total loans represents less than one-tenth of one percent of the $800 billion in total credit card debt held by Americans.283 Why are the loans on Prosper so small, and why is the market so marginalized? Why does Prosper not let lenders make loans of $100,000 or more?

One answer is that the adhesion doctrine hangs like the Sword of Damocles over every Prosper note.284 These are high interest loans to consumers, many of whom are poor and already highly indebted. Under current law, a court could easily conclude that the Prosper notes are adhesive to borrowers and are therefore subject to fairness review. This undermines, to some extent, the reliable enforceability that is needed for the exchange to function. This is an acceptable risk to take with small time contracts, but it would be untenable if "real money" were involved.285

The uncertainty created by the doctrine of adhesion is preventing consumer contract exchanges from reaching their full potential. Most markets "scale up" over time to take advantage of economies of scale, but we have not seen this effect in the consumer contract exchanges that currently exist.

282. Cf. Ellen Byron, The Just-in-Time Consumer, WALL ST. J., Nov. 23, 2010, at A1 ("This summer, Del Monte began reducing the number of canned fruits and vegetables in multi-packs . . . . The company realized consumers were more worried about overall cost, even if it meant a higher cost per can. . . . Smaller unit sizes . . . generally mean higher prices—and therefore higher profit margins for manufacturers.").


284. It should be noted that the adhesion doctrine does not affect every Hotwire hotel room because the consumer has already paid upfront, leaving only a business entity to perform.

285. Assume the risk of nonenforcement is 10%. A reasonable person with 90% confidence that the contracts would be enforced might be willing to contract for a $20 magazine subscription, but not a $20,000 car.
Hotwire transactions are usually a few hundred dollars or less, and most Prosper loans are for a few thousand dollars. At these dollar values, the transaction costs of litigation are so high that it is not a reasonable alternative. But at higher values, the threat of litigation could be a realistic one—so long as the contract is legally enforceable. And yet, higher value consumer contract exchanges are not observed in the real world, in part because of insecurity over the enforceability of exchange-traded consumer contracts.

Furthermore, there are a number of consumer contract exchanges that could theoretically exist, but currently do not, thanks in part to the adhesion problem. One could have an exchange where cellular telephone companies compete for consumers’ business. Or, consider that early stage funding for start-up companies often takes the form of credit card debt or loans from close or distant friends and family of the company’s founders, often known as “angels.” Theoretically, a peer-to-peer angel exchange for standardized business loans for hundreds of thousands, or even millions, of dollars, could be organized on the Internet. This would have the positive effect of democratizing entrepreneurship by allowing those who lack access to wealthy investors to have a more equal chance of obtaining sufficient funding for their fledgling business. Unfortunately, no such exchange exists at present.

One reason for the lack of these hypothetical exchanges is the uncertain enforceability of the contracts that would be created. This is not, of course, the only thing standing in their way. Other hurdles exist, such as a potential need for regulatory approval or industry cooperation. A secondary market in airline tickets, for instance, appears to be impossible, since even if Hotwire were to allow it, an industry-wide ban on the practice would still be in place. But the point is this: even were the other obstacles overcome, the adhesion problem would remain. Consider Prosper: the promissory notes and marketplace (that is, the contract exchanges) could not be legally enforced.

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286. See Darian M. Ibrahim, The (Not So) Puzzling Behavior of Angel Investors, 61 VAND. L. REV. 1405, 1406 (2008) (“[T]he prototypical angel is ‘rich old Uncle Joe, the wealthy, distant relative or family acquaintance.’”).

287. See generally Darian M. Ibrahim, Debt as Venture Capital, 2010 ILL. L. REV. 1170, 1178 (“[A] typical venture loan is anywhere from $2-10 million.”). Some very small angel-type loans are presently made on Prosper. See, e.g., About, 6TH MEGA, http://6thmega.com/about (last visited Feb. 22, 2011) (explaining that 6th Mega, a software development company, was “established and fully funded by peer-to-peer lending on the Prosper.com platform”).


289. See Ticketing—Name Change Restrictions, AM. AIRLINES, http://www.aa.com/i18n/agency/Booking_Ticketing/Ticketing/Name_Change_Restrictions.jsp (last visited Mar. 29, 2011) (“Most airlines have automation in place which will automatically cancel a booking if the name field is altered.”). Delta Airlines, however, has recently instituted something akin to a contract exchange for its tickets by asking passengers, at the time of booking, to “name their price” for being “bumped” from their flight to a later one. See Mike Esterl, Delta Makes Fliers Bid To Get Bumped, WALL ST. J., Jan. 14, 2011, at B1. If a flight is overbooked, Delta bumps those passengers that chose the lowest value and pays them their requested sum. See id. All parties can be expected to benefit from this new system: passengers will only be bumped at a price they deem fair; Delta will reduce the amount it has to pay to bumped passengers; and all will save time. See id.
secondary market) are regulated by the SEC, so there is no regulatory uncertainty. The business risk is all on the lenders, not Prosper itself. And yet, Prosper still has a maximum loan size of just $25,000.290

The remainder of this Part proceeds as follows: Section III.A describes the case law holding that although traditional exchange-traded contracts are by their nature adhesive, they should be strictly enforced so that the exchange (or secondary market) can function. Then, Section III.B analyzes the extent to which the case law pertaining to traditional contract exchanges can be extended and applied to the context of the consumer contract exchange.291

A. Traditional Contract Exchanges

When it comes to futures and other traditional exchange-traded contracts, the law is settled regarding adhesion. Numerous courts have observed that such contract exchanges are in the public interest and have recognized that their operation depends on the reliable enforceability of the standard form contracts used. They have, accordingly, held that although such contracts meet the literal definition of contracts of adhesion, they should be treated as if they were ordinary, negotiated agreements—that is, they should be not reviewed for fairness but rather be strictly enforced.292 Leading scholars, including some of the greatest critics of adhesion contracts, concur that the standard form contracts used on traditional contract exchanges, like CBOT, should not be subject to the special rules for adhesion contracts.293

The conclusion that traditional exchange-traded contracts should not be treated as adhesive has been based on three basic arguments. First, courts have relied on the idea that anyone who trades on a traditional contract exchange is a sophisticated party to whom the concept of adhesion has no application.294 The

290. It is also possible that the existing consumer contract exchanges satisfy the existing demand. But given how many Americans are interested in starting their own businesses, and how difficult it is to raise financing for such endeavors, see Schwartz, supra note 288, at 44, it seems likely that there is unmet demand for startup business capital.

291. The present discussion is focused on a common law solution, but legislative or regulatory solutions may also be possible. See, e.g., John J.A. Burke, Contract as Commodity: A Nonfiction Approach, 24 SETON HALL LEGIS. J. 285, 310-25 (2000) (describing a “Standard Form Contract Act” proposed (but never enacted) by the New Jersey Law Revision Commission).

292. E.g., Rudbart v. N. Jersey Dist. Water Supply Comm’n, 605 A.2d 681, 686 (N.J. 1992); Wilborn v. Bank One Corp., 906 N.E.2d 396 (Ohio 2009). This is so even though most traditional contract exchanges really do hold a monopoly on a given contract, so traders cannot take their business elsewhere. KOLB & OVERDAHL, supra note 5, at 53 (“We rarely see multiple exchanges offering similar contracts and competing head-to-head. Trading volume tends to migrate to one exchange and stay there.”); id. (“Once a market is established at a particular exchange, the cost of switching from the established, liquid market to a new, illiquid market can be prohibitively high. There are only a few instances in futures market history where an established contract has been pulled away to be hosted by a competing exchange.”).

293. Rakoff, supra note 34, at 1178 n.13 (excluding “exchange rules” from his definition of contract of adhesion); Slawson, supra note 202, at 48-49.

294. E.g., Met. Life Ins. Co. v. RJR Nabisco, Inc., 716 F. Supp. 1504, 1505, 1521 (S.D.N.Y. 1989) (holding that a corporate party that is “among the country’s most sophisticated financial
Second Circuit, for instance, rejected a claim that a futures contract traded on the London Metal Exchange was a contract of adhesion on the grounds that the supposed adherent was no rube, but rather a “sophisticated commodities trader with extensive experience in this field.”

Second, courts have held that regulated contracts should not be treated as adhesive because free-ranging judicial review for fairness of regulated contracts would be inappropriate in light of the regulatory scheme. Pursuant to the Securities Act and the Securities Exchange Act, for example, investors must be “given all materials necessary to make an informed decision” when investing in securities. In passing those statutes, Congress specifically rejected a substantive “governmental review” of the “risk, fairness, good sense, or other substantive qualities of the offered security.” In light of that legislative judgment, it would be inappropriate for a court to treat an investment contract governed by the SEC as a contract of adhesion and review it for fundamental fairness.

In a similar vein, the “conforming” residential mortgages that have been traded in a secondary market since the early 1970s are on standard forms, as they must be. These forms were drafted in an elaborate public process that incorporated suggestions from lenders, consumer advocates (including Ralph Nader), legislators, and others. For this reason, although such mortgages “may well resemble contracts of adhesion,” courts have recognized that they should not be treated as such.

Third, and most importantly, courts have relied on the public policy importance of contract exchanges to flatly override the usual rules that pertain to contracts of adhesion. They have recognized that the liquidity and other benefits of fungible contracts are so valuable that any concerns over the adhesive nature of such contracts must be set aside.

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296. E.g., Rudbart, 605 A.2d at 688.
297. Id. at 689.
298. Id. ("[J]udicial review of the fairness of negotiable securities would be inconsistent with federal and state securities laws.").
300. Id.
301. E.g., Rudbart, 605 A.2d at 688; Wilborn, 906 N.E.2d 396; Rakoff, supra note 34, at 1178 n.13; Slawson, supra note 202, at 48-89; see also Sharon Steel Corp. v. Chase Manhattan Bank, N.A., 691 F.2d 1039 (2d Cir. 1982) (citing Broad v. Rockwell Int'l Corp., 642 F.2d 929, 943 (5th Cir. Apr. 1981) (en banc)).
302. Wilborn, 906 N.E.2d at 407 ("[P]ublic policy strongly favors" the strict enforcement of "uniform mortgage forms" to "permit the trading of Ohio's conventional mortgages on the secondary market.").
Supreme Court case of *Rudbart v. North Jersey District Water Supply Commission* provides an example of this type of case.\textsuperscript{303}

In *Rudbart*, a public water utility issued $75 million in promissory notes to the public—a standard tax-exempt government bond offering. Sometime later, the utility sought to redeem the notes early and published notice to that effect, as it was permitted to do under the terms of the notes.\textsuperscript{304} Some of the noteholders apparently did not see the notices and failed to redeem, leaving them with an unattractive cash-out price.\textsuperscript{305} They sued the utility, claiming that the notes constituted a contract of adhesion with an unfair term, namely the publication notice provision. The trial court summarily dismissed this argument.\textsuperscript{306} But the appellate court reversed, holding that “a note or other security sold to the general investing public pursuant to standard form contractual provisions is a contract of adhesion” and therefore subject to a substantive judicial review for fairness.\textsuperscript{307} The ruling created an uproar and was appealed to the New Jersey Supreme Court.\textsuperscript{308}

The New Jersey Attorney General, who joined the suit at that point as amicus curiae, explained that the “transfer of securities in the primary and secondary market hinges upon the certainty of the terms of [those] securities, and the assurance that those terms cannot be overridden by judicial fiat.”\textsuperscript{309} The appellate court’s ruling, by calling that assurance into question, threatened to “wreak havoc in the securities markets,” according to contemporaneous news accounts.\textsuperscript{310} In other words, by treating the notes as contracts of adhesion, the appellate panel undermined the reliable enforceability that is necessary to the functioning of the secondary market.\textsuperscript{311}

The New Jersey Supreme Court understood that the appellate court’s ruling threatened to destroy the secondary market for New Jersey government bonds, and perhaps many other contracts.\textsuperscript{312} As such, it pragmatically held that

\begin{itemize}
\item \textsuperscript{303} *Rudbart*, 605 A.2d at 687. *Rudbart* concerned the government bond market, which did not take place on a contract exchange, but its reasoning applies with at least as much force to a contract exchange.
\item \textsuperscript{304} *Id.* at 683-84.
\item \textsuperscript{305} *Id.* at 684.
\item \textsuperscript{307} *Id.* at 1216-17 (finding that the publication notice provision was “unfair” and thus unenforceable).
\item \textsuperscript{308} See Lynn Stevens, *Appeal Weighed of N.J. Ruling That Could Disrupt Markets*, BOND BUYER, Jan. 4, 1991, at 1 (“This is the first time that a court has held that the doctrine of a contract of adhesion can be applied to a security. If the Supreme Court of New Jersey doesn’t do something to reverse the ruling, or to clarify it or put it on a different footing, it will unsettle the capital markets.”) (quoting Peter N. Perretti, Jr., an attorney representing the American Bankers Association)).
\item \textsuperscript{309} *Rudbart*, 605 A.2d at 682-83.
\item \textsuperscript{310} Stevens, *supra* note 308.
\item \textsuperscript{311} See *supra* Subsection I.A.1.b.
\item \textsuperscript{312} *Rudbart*, 605 A.2d at 686-88; *Id.* at 682 (“The decision [below] has the potential of opening to scrutiny by the courts the terms and conditions of notes and securities that have been sold to the public by governmental agencies throughout the State.”).
\end{itemize}
the doctrine of adhesion should be ignored in this instance due to the public policy importance of functioning contract exchanges:

The project notes involved here unquestionably fit our definition of contracts of adhesion. That is, they were presented to the public on standardized printed forms, on a take-it-or-leave-it basis without opportunity for purchasers to negotiate any of the terms. . . .

. . . [But strict] enforcement of their terms advances rather than contravenes well-established and important public policies [in support of the] freedom of transferability which is essential to the negotiability of investment securities. Subjecting the terms of [the notes] to continual judicial determinations of fairness would seriously impair the reliability and transferability of such instruments. . . .

. . .

We therefore conclude that although the project notes fit our literal definition of contracts of adhesion, plaintiffs are bound by [their terms] because of [these] unique policy considerations . . . . 313

Thus, thanks to cases like Rudbart, traditional contract exchanges are safe from the threat of the doctrine of adhesion. The same cannot be said for consumer contract exchanges, however.

B. Consumer Contract Exchanges

Courts have used three theories to shield traditional contract exchanges from the doctrine of adhesion: sophistication, regulation, and public policy. 314 Can any of these three arguments be used to protect contracts traded on consumer contract exchanges from the concept of adhesion?

As for the first argument, regarding trader sophistication, one can plainly see that this rationale is by definition unavailable in the consumer context. 315 And as for the second argument, it can be applied to a regulated exchange like Prosper, which operates under the watchful eye of the SEC, but that is an exceptional case. Much more commonly, consumer contracts and consumer contract exchanges are not directly regulated.

This leaves only the third argument—public policy—as a reason to reliably enforce the contracts of adhesion created or traded on consumer contract exchanges. As we have seen, consumer contract exchanges are highly beneficial to consumers, both in theory and in practice. 316 Hotwire and Priceline provide consumers with the lowest prices available, and Prosper

313. Id. at 687-89 (emphasis added).
314. See supra Section III.A.
315. See Miller, supra note 211, at 493.
316. See supra Sections I.B-.C.
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offers attractive loan terms to consumers. This is all beneficial to consumers and in the public interest.

Recall that the underlying assumption of the adhesion doctrine is that a consumer that agrees to a nonnegotiable standard form contract must have been at a severe bargaining disadvantage compared to their counterparty.317 But in the case of a consumer contract formed or traded on an exchange, the link between nonnegotiability and unequal bargaining power is broken. Rather than allowing consumers to be dominated, contracts of adhesion created or traded on consumer contract exchanges have precisely the opposite effect—they amplify consumers’ bargaining power.

Thus, consumers that participate in consumer contract exchanges have roughly equal, if not more, bargaining power than their counterparties, as can be seen by the attractive rates and prices obtained. In other words, the policy concern over contracts of adhesion is not really present in a consumer contract created or traded on an exchange, as the competition of the exchange substitutes for bargaining over terms. The surprising result is that the policy of the adhesion doctrine—to protect consumers—is best achieved by ignoring the doctrine in the context of consumer contract exchanges.

This is not to say that the contracts created or traded on consumer contract exchanges are not adhesive; clearly they are. However, just as they have already done in the context of traditional contract exchanges, courts should candidly recognize that while exchange-traded consumer contracts are adhesive, they are also extremely beneficial to their adherents. Indeed, they are so beneficial that public policy demands such contracts be reliably enforced. Any other conclusion would have the terrible effect of denying consumers access to contract exchanges and all of their attendant benefits.319 In short, the doctrine of adhesion should not be applied to exchange-traded consumer contracts.320

Assume that this recommendation is adopted as law. What about the possibility that bad actors could exploit the protection from fairness review to impose harsh terms on consumers? After all, consumers are not sophisticated traders able to protect themselves and, as yet, there is no protective regulation of these exchanges. For example, a group of payday lenders could establish a contract exchange and lawfully impose terms on its customers that would never pass muster today.

317. See supra Part II.
318. See supra Section II.A.
319. See Leff, supra note 210, at 557 ("[T]he benevolent have a tendency to colonize, whether geographically or legally.").
320. This Article does not call for the abolition of the special legal regime surrounding contracts of adhesion, see supra Section II.C, but merely for an exception to be made when a contract of adhesion is traded on an organized exchange.
Consumer Contract Exchanges

There are at least two responses to this worst-case scenario: market competition and future regulation.\(^{321}\) Competition should have the effect of driving bad actors out of the market. In the payday lending scenario, a rival lending exchange that offers better terms to its customers can be expected to garner more customers and attract customers away from the predatory lender. Consumers are not sophisticated in the sense of futures traders, but they can be expected to compare prices and choose the most advantageous offer, especially on the Internet, where comparisons are immediate. In addition, expert information intermediaries, such as Consumer Reports, can examine terms and provide consumers with a simple score, rating, or review of contractual terms.\(^{322}\) This bare minimum of competitive pressure should limit the size and impact of bad actors.

There may also be a role here for regulation in the future,\(^ {323}\) in particular because many traditional contract exchanges tend toward monopoly.\(^ {324}\) Butter contracts are traded on one exchange, wheat contracts on another, and gold contracts on a third.\(^ {325}\) This is because the more liquid a market, the better; once a dominant market player establishes itself for a given contract, all traders will flock there.\(^ {326}\) But things may be different in the context of online consumer contract exchanges. Witness that Prosper and its primary rival, Lending Club, both have almost exactly the same amount of loans funded.\(^ {327}\)

Were one to include a harsh term in their standard form loan agreement, word would surely spread among these Internet-savvy consumers, and they would trend toward the other.\(^ {328}\)

Whether, and what type of, regulation will ultimately prove necessary is a question for another day when consumer contract exchanges have flowered into

\(^{321}\) In addition, an action for rescission based on fraud would be available.

\(^{322}\) This is already happening in other spheres, such as the online social network Facebook. See, e.g., Brad Stone and Brian Stelter, *Facebook Backtracks on Use Terms*, N.Y. TIMES, Feb. 19, 2009, at B1 (reporting that a blog run by Consumer Union, publisher of Consumer Reports, flagged a change to Facebook’s Terms of Service giving Facebook rights to users’ pictures, videos, blog posts, and messages, even after users left Facebook, which “set off an explosion of activity that overwhelmed Facebook[],” including threatened litigation).


\(^{324}\) See sources cited supra note 292.

\(^{325}\) Id.

\(^{326}\) Id.


\(^{328}\) But what about really onerous and offensive terms? Without the adhesion doctrine, will a court be forced to enforce that term against an unwilling borrower? Another contract doctrine, one that applies to all contracts, whether adhesive or negotiated, will come into play in such circumstances. That doctrine holds that contracts or terms that are contrary to “public policy” will not be enforced. See *Restatement (Second) of Contracts* § 178 (1981). Hence, illegal contracts, such as for murder, are not enforceable. There is no need to resort to adhesion doctrine to come to this conclusion.
their full potential. But that cannot happen until the present uncertainty over the reliable enforceability of exchange-traded consumer contracts is lifted. The courts should therefore resolve this issue and hold that exchange-traded consumer contracts should not be treated as contracts of adhesion but rather should be reliably enforced as if they were ordinary, negotiated contracts.

Conclusion

This Article has argued that the common law should adjust, as it always has, to new and changed circumstances. The common law surrounding contracts of adhesion was developed as a means to protect consumers. But in the case of consumer contract exchanges, application of that doctrine would have precisely the opposite effect. The courts should therefore clarify that contracts created or traded on consumer contract exchanges will be enforced as if they were ordinary, negotiated agreements, despite the fact that they fit the literal definition of contracts of adhesion.