

## Contract Law and the Control of Standardised Terms in Consumer Contracts: An American Report

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1. There is a remarkable normative consensus in American academic thought that agreement to a standard form contract (SFK) is not sufficient in itself to justify enforcement according to its terms. In contract law generally agreement normally justifies enforcement of terms in contracts. This result is commonly rationalised either (1) on the theory that the parties to the contract know best their particular circumstances and have appropriate incentives to act responsibly; hence enforcement of their agreement is 'efficient', or (2) out of respect for the autonomy of the parties' property and liberty rights. Exceptions to the general rule of enforcement are usually premised on some defect in one party's consent to the contract (e.g., incapacity, or duress) or the inappropriateness on the parties' shared objective (illegality).

Agreement to a SFK on the other hand, in the normal manner in which such consent is manifested, while normally deemed sufficient to establish that some kind of contractual relationship exists, is not ordinarily viewed as legitimising enforcement of all the written terms in a SFK. This is because consent to the existence of a contractual relationship is not considered consent to the detailed terms of a SFK in any meaningful sense. Karl Llewellyn's work has been particularly influential here. He articulated a distinction between 'dickered' terms - ones the parties discussed, bargained over, and truly consented to - and boilerplate terms - standard terms in small print, never read, and not understood.<sup>2</sup>

This remarkable consensus in American legal thought does not mean that scholars believe SFKs should never be enforced as written in American courts. They are often so enforced,<sup>3</sup> sometimes appropriately. The consensus in American academic thought is that the reasons for enforcing terms in a SFK as written must be different from the usual reasons for enforcing contracts as agreed upon. And because consent is not

<sup>1</sup> I received valuable comments on earlier drafts from my colleagues, Professors Stewart Macaulay and Neil Komisar, and from the participants at the Conference. I received valuable research assistance from Mary Simons and Theodore Allegaert, students at Wisconsin Law School. All responsibility for errors and the views stated is mine.

<sup>2</sup> K. LLEWELLYN, *The Common Law Tradition: Deciding Appeals*, 1960, 370-71: 'Instead of thinking about "assent" to boiler-plate clauses, we can recognise that so far as concerns the specific, there is no assent at all. What has in fact been assented to, specifically, are a few dickered terms, and the broad type of transaction... The fine print which has not been read has no business to cut under the reasonable meaning of those dickered terms which constitute the dominant and only real expression of agreement....'

<sup>3</sup> Unfortunately, they are probably all too often enforced on the ground that the consumer party 'agreed' to them, even though such agreement in no meaningful sense manifested consent. A consensus in academic legal thought does not always translate into a consensus among judges. See generally T. Rakoff, "Contracts of Adhesion: An Essay in Reconstruction", 96 *Harv. L. Rev.* 1174, 1183-90 (1983).

deemed sufficient in itself to justify enforcement, it creates the possibility of regulation of the terms of SFKs on grounds other than the usual grounds for regulating contractual terms (duress, illegality, etc.).

2. There is also a remarkable agreement among legal academics that SFKs are a good thing. Most obviously, they reduce transaction costs, by negating the need to bargain about terms before forming a contract. More importantly, they permit a bureaucratic organisation to centralise decisions about the content of its legal obligations. Without standard form contracts, large bureaucratic sellers would need to give more discretion they want to sales people (who negotiate their contracts) to act in the company's interests. This ability to centralise decision-making is considered especially important when the seller assumes large risks, such as in insurance contracts. SFKs are also essential if we are to have fungible goods marketed at fixed prices. Since the terms of the contract bear on the seller's costs, standard (i.e., non-bargained) prices are only possible if the seller can control this cost in advance. Non-bargained prices imply non-bargained terms. These advantages of SFKs were recognised early by Llewellyn and Kessler, and have been emphasised more recently in the writing of Leff and Macneil.<sup>4</sup>

3. Two obvious questions that must be addressed in devising regulation of the terms of SFKs are: (1) what principles should determine when terms are enforced as written and when other provisions are substituted (the question of standards); and (2) what mechanisms should be used or created to insure obedience with these principles (the question of enforcement). A third, less well recognised, question is what institution or institutions should decide these questions.

American scholarship has identified three possible institutions for addressing the standards question: the market, courts, and legislatures. With respect to the enforcement question, the obvious mechanism is the courts, activated by a consumer aggrieved by violation of standard rules. However, administrative mechanisms, or public prosecution, are possible enforcement mechanisms, though in America they can be used only when a legislature first authorises their use for these purposes.

I will begin my analysis with the institutional question. My analysis is heavily influenced by the analytic structure developed by my colleague, Professor Neil Komesar, which he calls comparative institutional analysis.<sup>5</sup> Komesar seeks to put the question of 'who decides' at the forefront of legal/social analysis. Komesar demands that we compare the advantages and disadvantages of relying on each institution to resolve a question, and I will take that approach in addressing the standards issue. I will address the enforcement question more 'interstitially' - that is, from time to time as the analysis proceeds.

<sup>4</sup> K. LLEWELLYN, *op. cit.* note 2, at 262-371; F. Kessler, "Contracts of Adhesion: Some Thoughts About Freedom of Contract", 43 *Colum. L. Rev.* 629 (1943); A. Leff, "Contract as Thing", 19 *Am. U. L. Rev.* 131 (1970); I.R. Macneil, *The New Social Contract* (1980).

<sup>5</sup> N. KOMESAR, *Imperfect Alternatives: Choosing Institutions in Law, Economics, and Public Policy*, Univ. of Chicago Press, 1994.

## The Market

4. At first glance it would seem that the market is the problem and cannot be part of the solution. We are concerned with the regulation of the content of SFKs only because in the market we do not have the kind of consent to SFKs that legitimises the substantive content of other kinds of contracts. But a number of commentators have argued that even in the absence of consent to each contract, the market operates to regulate the terms of SFKs. In their view, the validity of SFK terms can be and often is legitimised by operation of the market even if not by individual consent.

5. Craswell argues that, to the extent sellers operate as monopolists or oligopolists, they have an incentive to offer consumers non-price terms that parallel with those that consumers would negotiate in a perfectly functioning market. Economic theory predicts that monopolists will find it more to their advantage to exploit their advantages through higher prices than through exploitative terms.<sup>6</sup> Consequently, the market can potentially serve to legitimise the content of SFKs even in monopolistic or less than competitive markets.

6. The affirmative case for reliance on the market to legitimise the content of non-price terms in SFKs rests on the assumption that the purchasing choice of a small number of consumers is influenced or determined by the content of non-price terms of the SFKs that are offered. It is argued that if this number reaches some reasonably small critical number, and if sellers cannot differentiate their SFKs among customers, then they will choose to adjust their SFKs to meet the desires of the shopping consumers. They will choose instead to compete on price, whether the market is competitive or monopolistic.<sup>7</sup> If we make the further assumption that consumer tastes are reasonably homogeneous, sellers efforts to satisfy the desire of shopping consumers will in fact benefit all consumers. As a consequence reliance on the market to determine the content of SFK terms will best serve consumer interests.

On its assumptions, this account presents a plausible theory of how the market operates to determine that the content of SFKs is consistent with consumer interests. Yet many question the reasonableness of the essential assumptions.<sup>8</sup> Why, for example, should we assume that consumers who shop with respect to non-price terms have the same tastes as non-shopping consumers?<sup>9</sup> And why should we assume that the number

<sup>6</sup> R. CRASWELL, "Property Rules and Liability Rules in Unconscionability and Related Problems", 60 *U. Chi. L. Rev.* 1 (1993), at text preceding note 80.

<sup>7</sup> A. SCHWARTZ & L. WILDE, "Information in Markets For Contract Terms: The Examples of Warranties and Security Interests", 69 *Va. L. Rev.* 1387 (1983).

<sup>8</sup> D. SLAWSON, "The New Meaning of Contract: The Transformation of Contracts Law By Standard Forms", 46 *U. Pitt. L. Rev.* 21 (1984).

<sup>9</sup> Priest noted that there is some variance in the non-price terms of SFKs offered by competing sellers, and concluded from this observation that when variance does not exist, it must be because there is a homogeneity in the preference of consumers with respect to non-price terms. Hence, it can be assumed that uniform terms offered by sellers still reflect consumer preferences. G. PRIEST, "A Theory of the Consumer Product Warranty", 90 *Yale L.J.* 1297 (1981). I have criticised this perspective in W. WHITFORD, "Comment On a Theory of the Consumer Product Warranty", 91 *Yale L.J.* 1371 (1982).

of consumers who shop with respect to non-price terms is large enough to induce any type of market response by most sellers?

7. If very few consumers take the initiative to inform themselves and shop with respect to non-price terms, then there is an alternative account of how even a competitive market operates that suggests we cannot rely on the market to legitimise the content of SFKs. The problem is an information problem, and it can lead to a competitive equilibrium, known as 'lemon equilibrium', in which even in competitive markets the terms of transactions differ from what they would be in the absence of the information problem. As applied to SFKs, this condition could occur if sellers find it difficult to effectively communicate information to consumers about non-price terms. In such circumstances a seller offering better non-price terms, those more in keeping with the preferences of consumers when well informed, may have a hard time recouping the extra costs of offering better non-price terms through higher prices. The seller offering the most restrictive non-price terms but offering the lowest price will fare better in the market, because consumers are much more likely to learn about price terms than non-price terms. The result is a competitive equilibrium in which no seller attempts to compete with better non-price terms and we get an equilibrium with a restrictive set of non-price terms. For example, insurance companies are likely to compete on price but not less restrictive exclusions from coverage because of the difficulty of effectively communicating information concerning the latter.

This description of marketplace forces with respect to the content of SFKs is consistent with many observer's impressions of existing practices.<sup>10</sup> It can account for the similarity in non-price terms offered by competing sellers, even as they compete vigorously with respect to price or some other visible characteristic.

8. One of the necessary assumptions to the argument in favour of market legitimisation of SFK terms is each seller offers all its consumers the same SFK terms. Sellers do not often draft special SFK terms for consumers who shop with respect to non-price terms. But it is common for a seller dealing with such a consumer to urge her to sign the SFK as originally prepared, on the assurance that the provision provoking concern will not be enforced as written.<sup>11</sup> And these assurances are frequently fulfilled by the seller, particularly if the consumer is a prospective repeat customer. It is in the practice of not enforcing SFKs as written that sellers commonly differentiate between consumers, meeting the demands of those consumers whose purchasing decisions are dependent on the content of non-price terms while not extending the same benefits to other consumers.

I described an example of this phenomenon in a study of the administration of new car warranties.<sup>12</sup> Sellers put restrictions on the availability of repairs under warranty.

<sup>10</sup> See CRASWELL, *op. cit.* note 6.

<sup>11</sup> One function of SFKs within the seller's firm is to centralise decision-making with respect to non-price terms. Hence the salesperson negotiating the transaction normally will not be authorised by the firm's internal rules to change the written terms of the SFK. It will often be easier for this salesperson to insure a deviation from normal practices in the performance of a SFK. See generally RAKOFF, *op. cit.* note 3, at 1222-29.

<sup>12</sup> W. WHITFORD, "Law and the Consumer Transaction: A Case Study of the Automobile Warranty", 1968 *Wis. L. Rev.* 1006.

For example, many repairs are not covered by warranty after passage of a reasonably short period of time, such as one year after purchase. Sellers, however, often make free repairs 'out of warranty', but only for preferred customers. This practice allows car sellers to differentiate effectively the warranty terms they extend to different buyers.

9. Professor Lon Fuller described a related phenomenon long ago in a description of insurance contract practices. Insurers insert boilerplate clauses that allow them to deny coverage for reasons that commonly occur, yet only infrequently alter the insurer's risk. A common example is a clause providing for denial of coverage if a claim is not filed within a stipulated time. The insurer may assert this clause to deny coverage, even though the real reason for denial of coverage is something entirely different, such as a belief that the loss claimed did not really occur. The insurer fears that the real basis for the claim denial would not be sustained in court, perhaps because courts are inclined to favour consumers over insurance companies when the facts are reasonably contested. Consequently, the insurer bases denial on the boilerplate clause, which presents little juridical risk (because violation of the stipulated condition is clear) so long as the validity of the clause is upheld. In many cases, however, the insurer waives violation of the boilerplate clause. Indeed it is never the insurer's intention to deny all claims when the condition stipulated in the boilerplate clause occurs, but only to assert the clause to insulate the real reason for claiming denial from judicial review.<sup>13</sup>

This example, as well as the automobile warranty example, show how sellers often differentiate contract terms. The differentiation is not made at the time of contract formation but during performance. The consumer is not likely to notice or comment on the term at issue at the time of formation. But when the term poses a barrier to a desired contract performance (a warranty repair or payment of a claim), the seller often but not always waives its rights under the term. The waiver no doubt often includes an implicit promise (though not necessarily a legally enforceable one) that performance of the next contract will include the same favourable treatment if needed or requested.

10. I am particularly attracted to the explanation that sellers respond to marketplace pressures by differentiating their performance of SFKs rather than adjusting non-price terms. This view is consistent with commonplace assumptions about how the world works. Professor Slawson has related his experiences as a drafter of SFKs in his pre-academic life and reports that no client ever asked him to do anything other than to draft the non-price terms in as one-sided a manner as the law allowed.<sup>14</sup> Yet we know that some consumers are concerned about non-price terms and inform themselves about them. This explanation can account for how sellers in a competitive marketplace seek the patronage of such consumers, while maintaining the common assumption that

<sup>13</sup> See L. FULLER, *Basic Contract Law*, West Publishing Co., 1st ed., 1947, 213-14. Fuller used a different example than I have used in the text to illustrate the same point. His example concerned a condition in industrial life insurance policies that excluded coverage if the insured was not in 'sound health'. Despite the clause, Fuller said that insurers would not normally deny coverage if death resulted from an illness that existed at the time of application but was undetected, but they would hide behind the clause when they believed the insured knew of the ultimately mortal illness at the time of application. The insurers preferred to avoid the juridical risk of having to prove the applicant's knowledge at the time of application; the clause, if enforced as written, allowed them to deny coverage simply by showing that the illness existed then.

<sup>14</sup> SLAWSON, *op.cit.* note 8, at 44.

marketplace forces have little effect on the substantive content of non-price terms of SFKs.

My analysis has suggested that very frequently the content of SFKs is more restrictive to consumer interests than the actual administration of the contracts. This raises the question whether we should be concerned at all with the actual content of SFKs, or focus exclusively on the manner of contract administration. Since in legal theory it is the content of the written contract that determines legal rights, it has been the traditional focus of analysis, and I believe that some concern with the actual content of the contract is important. There will always be consumers, and in some industries a large number of them, who will not receive the benefit of generous administration of the SFK - perhaps because their continued patronage is no longer desired,<sup>15</sup> perhaps because their sellers are facing financial distress, or for some other reason. Their legal rights will be determined, or at least influenced, by the content of the written contract, and frequently the circumstances which disqualify them from the benefits of generous contract administration are not ones which should disadvantage them.

Even more importantly, however, the written content of a SFK plays an important role in informing consumers of their rights. Many consumers will not make a demand on a seller after having read the SFK and learning that they have no rights. For example, a consumer may not ask for a car repair after learning that it is 'out of warranty', even if advertising and sales presentations reasonably led the consumer to believe that the malfunction would be covered by the warranty.<sup>16</sup> Differentiation among consumers through contract performance is preeminently a process that favours the assertive and disfavours the meek. If differentiation is considered undesirable, concern about the content of the written terms is one way to combat it. Those terms play an important role in informing consumers of their rights, and unless consumers make demands on sellers, they will not receive the benefits that perhaps they should.<sup>17</sup>

11. In summary, while the market undoubtedly exerts some influence over the content of non-price terms in SFKs, most commentators believe this influence is limited. But

<sup>15</sup> Merchants are likely to consider most advantageous the repeat business of wealthier customers, because they can buy more and because their continued patronage can enhance the merchant's reputation. Furthermore, in current American society poorer consumers, and racial minorities, are likely to have fewer purchasing options, and merchants will have less need to cater to their whims in contract administration in order to win their continued patronage. See I. AYRES, "Fair Driving: Gender and Race Discrimination in Retail Car Negotiations", 104 *Harv. L. Rev.* 817 (1991). Consequently, reliance on market forces rather than enforcement of contractual rights to determine consumer benefits can disadvantage relatively the less well off.

<sup>16</sup> My colleague Stewart Macaulay, in an unpublished memo, has described the following scenario as 'common and troubling': '(1) firms spend a fortune advertising in all the mass media, and these ads create impressions; (2) sales people, packaging or both reinforce these impressions as they sell the product; (3) the seller uses a SFK that undercuts the impressions created by the advertising and sales persons' representations; (4) the buyer signs the contract without reading or understanding or, more commonly, *s/he* makes an agreement but the SFK is buried in the package so that it cannot be read until the consumer opens the box; (5) trouble comes; and (6) the seller asserts clause 23(z)(1) of the SFK.'

<sup>17</sup> This informative function of contract terms is what I once called 'post-contract' disclosure. It is one of the most important functions of the actual written document in a contractual relationship formed by a SFK. The written document is not read and not intended to be read before the contractual relationship is created, but it is often read, as if it were an instruction manual, when the consumer encounters difficulties and wonders whether a remedy can be sought from the seller. See W. WHITFORD, "The Functions of Disclosure Regulation", 1973 *Wis. L. Rev.* 400.

no final conclusion about the adequacy of the market is possible until an examination is made of other institutions (courts and legislatures) that could supply the terms of SFKs. My methodology in this paper is one of **comparative** institutional analysis.

I have saved my detailed discussion of what principles should guide the determination of the substance of SFK terms until the end of this paper. My first priority was to explore institutional issues. As a preliminary point, it is worth noting that the arguments that have been advanced for reliance on the market as an institution for determining the content of SFKs presuppose that the substance of SFK terms should reflect what fully informed consumers would prefer in a competitive market. To the extent that other principles (which I will refer to as redistribution and social planning) should guide determination of the substance of SFKs, complete reliance on the market as an institution will be excluded.

## Courts

12. Courts have been thought of as the traditional regulators of the terms of SFKs. Courts have often found ways to protect the rights of consumers by applying common law doctrines developed in the context of bargained contracts, such as duress and misrepresentation, and by interpreting the language of a term in a SFK to mean something other than what it was obviously intended to mean. In a very well known passage, Llewellyn criticised this approach as disingenuous. In these cases courts have treated SFKs as if there had been consent to all the terms, when there had not been. As a result, the reasons given for the results in these cases were not, according to Llewellyn, the real reasons for the decision. When judicial opinions fail to state the real reasons for a given ruling, those opinions fail to create a body of doctrine that enables drafters of SFKs and others to predict the outcome of future cases. Llewellyn believed that because of the resulting uncertainty in the law, drafters of SFKs did not have appropriate incentives to police themselves by avoiding clauses that the courts did not want to enforce. Instead, the drafters continually redrafted their SFKs, in the hope of preventing courts from distorting contract doctrines developed in the context of bargained contracts to accomplish their essentially regulatory objectives.<sup>18</sup>

13. The unconscionability section of the Uniform Commercial Code (§2-302) is widely considered to reflect Llewellyn's ideas about the inadequacies of pre-Code judicial treatment of SFKs.<sup>19</sup> The unconscionability section is notorious for failing to define 'unconscionability'. But enactment of the section did provide courts with an opportunity to discount the previous common law precedent, as not based on the new statute; it was this precedent that Llewellyn believed was so inadequate to the task of effective regulation of the terms of SFKs. Unconscionability could then have become the

<sup>18</sup> K. LLEWELLYN, "Book Review", 52 *Harv. L. Rev.* 700 (1939).

<sup>19</sup> Llewellyn wanted to make the unconscionability section a bit more specific than it presently is, but not in ways that require alteration of the subsequent text account of Llewellyn's justification for section 2-302. For accounts of the drafting history of this section, see M. MEYERSON, "The Reunification of Contract Law: The Objective Theory of Consumer Form Contracts", 47 *U. Miami L. Rev.* 1263 (1993); M.P. ELLINGHAUS, "In Defense of Unconscionability", 78 *Yale L.J.* 757 (1968).

doctrinal vehicle by which the courts developed a new 'common law', in the guise of interpreting unconscionability. In this new law, hopefully courts would state directly what they found objectionable in SFKs.

There is a great deal of evidence from Llewellyn's considerable writings on jurisprudence that he held this vision of the potential of section 2-302. Llewellyn believed that formal rules were not a good device for providing predictability of result. He believed that fact situations were impregnated with a 'natural law' - a result which all well-meaning and disinterested persons of sufficient intelligence would recognise as appropriate.<sup>20</sup> Llewellyn had great faith in the intelligence and integrity of judges. He believed that freed of the constraints of the need to show deference to some formal rule, courts would struggle with the fact situation until they discovered its 'reason' or 'natural law'. Moreover, because courts always struggled to avoid unjust results seemingly forced by a formal rule, and frequently succeeded by finding some way to avoid reaching the result seemingly mandated by the formal rule, freeing courts to pursue the 'reason' of a situation was a better way to provide certainty, or what Llewellyn preferred to call 'reckonability', in the law.<sup>21</sup>

14. The unconscionability section has spawned a tremendous quantity of law review articles, advocating this or that application of section 2-302. And in the late 1960s there were a series of cases which led to the hope that the section would provide an important vehicle by which the courts would actively regulate the content of SFKs used in transactions with lower income consumers.<sup>22</sup> But there is a general consensus today that section 2-302 has been a failure as a law reform vehicle. While courts will occasionally apply it to invalidate the application of a term of a SFK, they have done

<sup>20</sup> This attitude is well illustrated by the following passage, in which Llewellyn quotes approvingly a European lawyer: 'I doubt if the matter has ever been better put than by that amazing legal historian and commercial lawyer, Levin Goldschmidt: "Every fact-pattern of common life, so far as the legal order can take it in, carries within itself its appropriate, natural rules, its right law. This is a natural law which is real, not imaginary: it is not a creature of mere reason, but rests on the solid foundation of what reason can recognise in the nature of man and of the life conditions of the time and place; it is thus not eternal nor changeless nor everywhere the same, but is indwelling in the very circumstances of life. The highest task of law-giving consists in uncovering and implementing this immanent law."' K. LLEWELLYN, *op.cit.* note 2, at 122. The Goldschmidt passage quoted by Llewellyn comes from the Preface to *Kritik des Entwurfs eines Handelsgesetzbuchs*, *Krit. Zeitschr. f.d. ges. Rechtswissenschaft*, Vol.4, No.4.

<sup>21</sup> 'On reckonability of result, three points cry for attention: first, the Grand Style (Llewellyn's term for an approach to judging that seeks the "reason" in a situation, rather than application of a formal rule) is the best device ever invented by man for drying up that free-flowing spring of uncertainty, conflict between the seeming commands of the authorities and the felt demands of justice. Second, when a frozen text happens to be the crux, to insist that an acceptable answer shall satisfy the reason . . . is not only to escape much occasion for divergence, but to radically reduce the degree thereof. . . . Third, the future-directed quest for ever better formulations for guidance . . . means the on-going production and improvement of rules which make sense on their face, and which can be understood and reasonably well applied even by mediocre men. Such rules have a fair chance to get the same results of very different judges, and so in truth to hit close to the ancient target of "laws and not men."' K. LLEWELLYN, *op. cit.* note 2, at 37-38.

<sup>22</sup> E.g., *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965); *Toker v. Perl*, 247 A.2d 701 (N.J. Super. Ct., Law Div. 1968).



so infrequently, and certainly they have not created any broadly applicable new doctrine.<sup>23</sup>

15. Arthur Leff provided very cogent analyses of the failures of section 2-302.<sup>24</sup> The crux of his argument turned on the inherent uncertainty in the statute. The statute, although providing no definition of unconscionability, directs that a court consider all the circumstances surrounding the making of the contract before reaching a finding of unconscionability.<sup>25</sup> As a result courts are likely in any finding of unconscionability to limit its finding to the 'facts of this case' rather than attempt to forge a broad precedent. This type of decision, Leff argued, is rarely effective in inducing drafters of SFKs to make broad reforms, because they can always argue in the next case that the facts are sufficiently different to justify a different result. Some fact is always different, and that is sufficient to generate reasonable hopes of victory in the heads of SFK drafters so long as the result will depend on a detailed examination of the facts of the particular case. Ironically, Leff's critique of section 2-302 was almost identical to Llewellyn's criticism of judicial approaches to SFKs that Llewellyn had hoped would be replaced by section 2-302. Leff believed that more certain standards that were less dependent on the facts of a particular case would provide more effective regulation of SFKs, and that legislation was the best vehicle for providing them.

16. The failure of section 2-302 to become a significant vehicle for judicial regulation of SFKs has not caused most commentators to abandon the cause of judicial regulation.<sup>26</sup> One significant group of commentators have advocated a shift from the unconscionability concept to a 'reasonable expectations' test for the validity of a SFK term.<sup>27</sup> A reasonable expectations test provides for enforcement of a term in a SFK only if it would be consistent with the expectations of a reasonable consumer in the position of the buyer. If there were true consent to the term, it would meet the expectations of the reasonable consumer. Otherwise the condition would need to meet the pre-existing expectations of a reasonable consumer about the substantive content of a SFK.<sup>28</sup>

<sup>23</sup> See E. A. FARNSWORTH, "Developments in Contract Law During the 1980's: The Top Ten", 41 *Case W. Res. L. Rev.* 203 (1990); J. JOHNSON, "Unconscionability and the Federal Chancellors: A Survey of U.C.C. Section 2-302 Interpretations in the Federal Circuits During the 1980's", 16 *Lincoln L. Rev.* 21 (1985).

<sup>24</sup> A. LEFF, "Unconscionability and the Code - The Emperor's New Clause", 115 *U. Pa. L. Rev.* 485 (1967); A. LEFF, "Unconscionability and the Crowd - Consumers and the Common Law Tradition", 31 *U. Pitt. L. Rev.* 349 (1969).

<sup>25</sup> Uniform Commercial Code §2-302(2): 'When it is claimed . . . that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.'

<sup>26</sup> The courts' failure to develop the unconscionability doctrine has not prevented some academics from continuing to advocate that they should do so. See, e.g., S. BENDER, "Rate Regulation At the Crossroads of Usury and Unconscionability: The Case for Regulating Abusive Commercial and Consumer Interest Rates Under the Unconscionability Standard", 31 *Hous. L. Rev.* 721 (1994); C. HOROWITZ, "Reviving the Law of Substantive Unconscionability: Applying the Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts", 33 *UCLA L. Rev.* 940 (1986).

<sup>27</sup> M. MEYERSON, *op.cit.* note 19; D. SLAWSON, *op.cit.* note 8.

<sup>28</sup> The reasonable expectations test owes a considerable intellectual debt to the following passage from Llewellyn: 'Instead of thinking about "assent" to boiler-plate clauses, we can recognise that so far as concerns

The reasonable expectations approach has had only modest success in the courts. It has been accepted by a number of courts as an appropriate test for the validity of terms in an insurance contract, but outside the insurance area it has been applied sparingly. This result is a little surprising. After all, once one accepts that agreement to a SFK does not imply consent in any meaningful sense, the reasonable expectations test is thoroughly consistent with generally accepted contract principles. The guiding principle for interpretation of communications, known as the objective test, asks what a reasonable person in the position of the receiver of a communication would understand. The reasonable expectations test simply applies that principle, treating the written contract as one, but only one, bit of evidence of what a reasonable person would understand as the terms of a SFK.

17. Even if the courts were to adopt the reasonable expectations doctrine, I believe it would not have substantial impact on the great mass of transactions for reasons similar to the reasons the unconscionability concept has suffered a similar fate. There are essentially three reasons that deserve mention.

Stewart Macaulay has offered one explanation. He points out that the unconscionability doctrine relies on individuals initiating lawsuits to challenge the conduct of sellers, and emphasises all the barriers to litigation, particularly its cost. Macaulay has also documented a low visibility trend for states to authorise private lawsuits for damages under their statutes prohibiting unfair and deceptive trade practices. Such statutes have long existed, but only recently have individuals been authorised not only to bring private suits for damages but also to recover attorney fees and very modest punitive damages (perhaps \$1,000 per violation). Macaulay documents that, especially in Texas, there has been a significant volume of litigation under such statutes, a much greater volume than there has been under the unconscionability doctrine. Macaulay argues that most of these suits are ones that could have been brought under an unconscionability standard (or, I would argue, under a reasonable expectations test as well), but many probably would not have been brought absent the litigation incentives.<sup>29</sup>

18. The second reason that I would expect a reasonable expectations doctrine to have limited effect is similar to the principal reason given by Leff for the limited effect of the unconscionability doctrine on large numbers of transactions. So long as the outcome of a challenge to a term of a SFK depends on facts particular to each transaction, sellers

the specific, there is no assent at all. What has in fact been assented to, specifically, are the few dickered terms, and the broad type of the transaction, and but one thing more. That one thing more is a blanket assent (not a specific assent) to any 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. The fine print which has not been read has no business to cut under the reasonable meaning of those dickered terms which constitute the dominant and only real expression of agreement, but much of it commonly belongs in.'

K. LLEWELLYN, *op.cit.* note 2, at 370. Another important article that presages the reasonable expectations approach is A. LEFF, "Contract as 'Thing'", 19 *Am. U. L. Rev.* 131 (1970) (suggesting that a SFK can be seen as part of the product purchased and subject to implied warranties of merchantability and fitness for purpose).

<sup>29</sup> S. MACAULAY, "Bambi Meets Godzilla: Reflections on Contracts Scholarship and Teaching vs. State Unfair and Deceptive Trade Practices and Consumer Protection Statutes", 26 *Hous. L. Rev.* 575 (1989).

are unlikely to accept that they cannot achieve their objectives through drafting. Rather than changing their objectives, sellers are more likely to change their methods of trying to achieve the old objective. They will do this by such tactics as changing the language of the SFK term or some aspect of the disclosure accompanying the SFK, in the usually plausible hope that a future court will find that the circumstances are sufficiently different from some previous case where a SFK term was invalidated. And in this respect the reasonable expectations test is really no different than the unconscionability concept. Although the reasonable expectations of the consumer provide a judge more meaningful guidance in reaching a decision than the word 'unconscionability', the reasonable expectations test emphasises the reasonable expectations of the particular consumer involved in the contract. And that makes all the facts of the case relevant to the decision, including the particular circumstances in which the SFK was concluded.

19. My third reason for expecting limited impact of a reasonable expectations doctrine is derivative of the first two. There are obviously inadequate resources within the judiciary to review every contract. A requirement of inquiry into the particular circumstances of each case forecloses the possibility of class relief (in Europe called representative actions). In that circumstance the only way to induce merchants to change their objectives, rather than simply the means by which they try to accomplish their objectives, is to provide for substantial punitive damages. Substantial punitive damages can deter some sellers from a strategy of simply altering practices in small ways both by increasing the costs of having the strategy deemed inadequate by a court and by increasing the risk that the strategy will be challenged in court, since large punitive damages are a very significant litigation incentive.<sup>30</sup> However, substantial punitive damages are not likely to be established for a legal violation that requires a court to assess all the facts of the case. Concerns about fairness to the merchant normally convince lawmakers, especially in the commercial arena, that substantial penalties are inappropriate where substantive standard is defined in such a way as to lead to unpredictability in outcome.<sup>31</sup>

20. What I will call clear rules - rules whose application do not require inquiry into many particular facts about the making of a contract - avoid most of these barriers to effectiveness. Then class relief is often possible, such as an injunction against continued use of a SFK term in any consumer contract. Substantial punitive damages becomes more possible, though hardly inevitable. Perhaps most importantly, however, I believe

<sup>30</sup> Macaulay discusses state deceptive practices statutes that permit recovery of modest punitive damages. See *supra* note 29 and accompanying text. He reports that these litigation incentives, including recovery of attorney fees, have greatly encouraged litigation. Because the punitive damages are relatively modest, however, I question whether these deceptive practices statutes have had great impact in the vast majority of transactions never questioned by any consumer. It would be an interesting to see a study of the impact of the Texas Deceptive Practices Act on merchant behaviour.

<sup>31</sup> The most obvious exception to this proposition are 'civil RICO' actions for treble damages. See *SEDIMA, S.P.R.L. v. Imvrex Co.*, 105 S.Ct. 3275 (1985); RIVOIR, "Civil RICO - The Supreme Court Opens the Door to Commercial Litigation", 90 *Commercial L.J.* 621 (1985). Civil RICO actions are not generally available in consumer transactions, however. Furthermore, the availability of substantial punitive damages for such vaguely defined conduct is very controversial, and this experience is not likely to be a basis for extended the approach to other areas.

that sellers have a tendency to obey clear rules. Whether from a general attitude of law-abidingness or fear of adverse publicity, I believe that many sellers will obey clear legal mandates, even when the gains they stand to reap from continued use of the prohibited term exceed the damages or fines they would have to pay to consumers who assert their rights. These motives do not have so much impact, however, when application of the rule requires inquiry into particular facts, enabling sellers to convince themselves that there is at least a plausible argument that a modestly altered SFK term, one that does not abandon the seller's original objective, would be sustained in court.<sup>32</sup>

21. One judicial development in connection with SFKs which has not received the attention it warrants is the treatment of exclusion clauses of tort liability. This topic is especially important in America because product liability, at least where personal injury is involved, has generally been allocated to tort law rather than contract law, even where there is a contractual relationship between the parties. Courts have been much more willing to ignore written exclusion clauses of tort liability than other written terms of a SFK. In some jurisdictions such clauses will virtually never be enforced. In others there is a presumption against enforceability, but a seller might be able to sustain the clause if it can show something akin to true knowing consent to the clause.<sup>33</sup> And because the complaining party has frequently suffered personal injury and suffered substantial damage, the cost barriers to litigation discussed by Macaulay are not so great a deterrent to litigation in this area.<sup>34</sup>

The judicial treatment of exclusion clauses has not generally made the validity of such clauses depend on a detailed inquiry into the circumstances under which a particular contract was made. As a result, judicial doctrines in this area have had much greater impact than the doctrines of unconscionability and reasonable expectations. Because courts have so consistently refused to enforce exclusion clauses, sellers routinely presume full liability in tort when making pricing decisions. Sellers using SFKs still include exclusion clauses, and sometimes they even litigate in an effort to uphold them. But the latter are principally cases in which the seller also contests liability or the measurement of the buyer's damages, and litigation would have occurred in any event. Rarely, I believe, do sellers litigate to uphold exclusion clauses where that term is the only basis for avoiding or diminishing liability.

22. The example of exclusion clauses shows that courts are capable of adopting clear rules with respect to the enforceability of SFK terms. The question arises why they have not done so with respect to regulating other terms of SFKs. There are not clear answers to this question. I suspect that the fact that exclusion clauses relate to a liability

<sup>32</sup> I have developed this argument in greater depth in W. WHITFORD, "Structuring Consumer Protection Legislation to Maximize Effectiveness", 1981 *Wis. L. Rev.* 1018.

<sup>33</sup> See *Vathal Corp. v. Sullivan Assocs.*, 1995 U.S.App. LEXIS 15 (3d Cir. 1995); *Richards v. Richards*, 513 N.W.2d 118 (Wis. 1994).

<sup>34</sup> In the United States, medical care is a personal financial responsibility, so medical costs where there is substantial personal injury are likely to be high. Furthermore, all states permit recovery, as compensatory damages, not only for out-of-pocket expenditures but also for 'pain and suffering', understood to include emotional distress. Amounts recovered for the latter loss have been so substantial that there are now legislative movements to put upper limits on the amounts that can be recovered for such non-financial losses.

that American law labels as arising in tort is one factor. Tort law, unlike contract law, is an area where liability imposed on grounds of public policy is commonplace. This may make it easier for judges to refuse to enforce exclusion clauses without a detailed inquiry into particular circumstances to determine whether the buyer might be deemed to have consented to the exclusion.<sup>35</sup> Another concern may be that, with the noteworthy exception of exclusion clauses, general rules across all contracts respecting the enforceability of SFK terms may not be appropriate. What is needed are rules that vary with industry, as the commercial needs of different industries are different with respect to many of the matters dealt with by SFK terms. But courts may be uncomfortable when fashioning rules of contract law that are not general but vary by industry. In the American tradition that law-making task is more appropriately assigned to the legislature. Not to be ignored, moreover, is the change in prevailing political values in the United States. Some decisions in the late 1960's interpreting the unconscionability doctrine led many to hope that courts would fashion a generally accepted interpretation that would limit the retail markup of sellers operating predominantly in low income neighbourhoods to 100 percent or a little more.<sup>36</sup> But as the political climate became more conservative, the courts followed and have backed away from establishing this relatively clear rule.<sup>37</sup>

## Legislation

23. Legislation can mean many things. Section 2-302 itself is technically legislation, but in reality it is a delegation of law-making authority to the courts. By legislation in this paper I mean an enactment that provides the substantive principles that determine which SFK terms are valid and which are not. Administrative regulations pursuant to a delegation of legislative power are included within the definition of legislation.

24. Much effective regulation of SFKs has occurred through legislation in the past 30 years. Potentially legislation could require a court to examine many facts about the making of a particular contract before determining whether a SFK term is valid. For example, legislation might enact the reasonable expectations test in statutory form. Much legislation has been much more specific, however. It has established clear rules, limited to particular industries, such as the prohibition in all contracts with consumers of non-possessory, non-purchase money security interests in household furnishings.<sup>38</sup> And when it has done so, legislation has gained the advantages of clear rules that are mentioned above. A substantial degree of voluntary compliance by sellers can be presumed. Clear rules make class relief possible. Legislation has often provided for enforcement actions (commonly for class relief) to be initiated by public enforcement

<sup>35</sup> See H. COLLINS, "Good Faith in European Contract Law", 14 *Oxford J. Legal Stud.* 229 (1994).

<sup>36</sup> E.g., *American Home Improvement v. MacIver*, 105 N.H. 435, 201 A.2d 886 (1967); *Jones v. Star Credit*, 59 Misc.2d 189, 298 N.Y.S.2d 264 (1969).

<sup>37</sup> E.g., *Remco Enterprises v. Houston*, 9 Kan.App.2d 296, 677 P.2d 567 (1984).

<sup>38</sup> Federal Trade Commission Credit Practices Rule, 16 C.F.R. §444.2(a)(4)(1992).

agencies. I have argued in another article that public enforcement is potentially the most effective way to enforce consumer protection legislation.<sup>39</sup>

25. Legislation also has its limits. There is an increasing amount of literature on the inadequacies of the legislative process. Among other difficulties, emphasis has been given to the influence over legislative outcomes that is exerted by interest groups with few members but having large per capita stakes. The American political process is particularly susceptible to influence by such groups because of the lack of effective political parties and the expectation that each candidate will personally raise substantial campaign funds. Merchant sellers are much more likely to be members of influential groups than consumer buyers, and as the drafters of SFKs merchants are likely to favour non-regulation or regulation of limited effectiveness.

What has been called 'symbolic' legislation is one likely outcome of a legislative process which is subject to such influences.<sup>40</sup> Symbolic legislation in the consumer context is designed to appear to help the consumer but largely fails to reach this goal in practice. Symbolic legislation can seem quite attractive to a legislator where there is a well informed merchant group who will understand that the legislation will have limited impact and a less informed and organised consumer group who will not.

Disclosure regulations are an excellent example of symbolic legislation. By disclosure regulation I mean legislation requiring sellers to disclose information to consumers in some prominent way, and it frequently applies to the terms of SFKs. The stated purpose of disclosure regulation is normally to stimulate informed consumer shopping behaviour with respect to the matters disclosed, so that the market becomes a more effective regulator of the content of SFK terms with respect to such matters. Some disclosure regulation has had modest impact in that way, but most disclosure regulation has had almost no impact on consumer shopping behaviour or consumer understanding of the terms of the contract they enter.<sup>41</sup> Consumers simply ignore the disclosures, even if made prominently. In such cases disclosure regulation can be seen as legislation that appears to protect consumers without in fact doing so in any significant way.

26. I believe that in the United States on the whole legislation has been much more effective than judicial oversight in regulating SFKs. This is because legislation has provided so many more clear rules. It need not have been that way. Courts could have fashioned clear rules, and established procedures for class relief, as to some extent they have with respect to exclusion clauses. There is some reason to believe that

<sup>39</sup> WHITFORD, *op. cit.* note 32, at 1018. In the absence of specific authorising legislation, public authorities in the United States are usually presumed to lack authority to initiate litigation to protect the private interests of citizens.

<sup>40</sup> The term is generally credited to Professor Murray Edelman. See M. EDELMAN, *The Symbolic Uses of Politics*, 1964.

<sup>41</sup> I believe the Magnuson-Moss Warranty Act, 15 U.S.C. §2301-2311 (1992) is an excellent example of such legislation. See generally WHITFORD, *op. cit.* note 15.

Llewellyn wanted courts to use the unconscionability principle as a vehicle to do just that.<sup>42</sup> But they have not.

I have advocated clear rules, because of their greater potential effectiveness. Inevitably, however, clear rules foreclose some welfare enhancing transactions. There will always be some consumers who would make knowing decisions to enter into transactions which are prohibited by clear rules, in circumstances in which more observers would agree that their personal welfare would be enhanced if they were allowed to conclude the transaction. For example, legislation now prohibits a consumer from granting non-possessory, non-purchase money security interests in household furnishings. Some consumers would be better off granting such security interests, either because it is the only way they could get a credit extension, or because they would benefit from the additional discipline provided by the fear of loss of household furnishings if debts are not paid on time. The case for clear rules is that the benefits of enhanced effectiveness outweigh the costs of foreclosing a few welfare enhancing transactions. I believe that is often the case, though it is a judgment that must be made separately for each regulatory intervention.<sup>43</sup> That is one reason clear rules are generally made industry specific, a characteristic, I have suggested above, that in the United States has made their adoption easier by legislation than by judicial innovation.

### Substantive Objectives of Regulation

27. I have first directed my comments to the question of which institution should regulate SFKs, because I believe it is the most important and neglected question. Analytically an anterior question is what should be the substantive objectives of regulation of SFK terms, since each institution will be better suited to implement some goals than others. In the vast literature about regulatory objectives, there are essentially three positions taken. Many believe the primary objective should be to have SFK terms replicate the terms that would be negotiated by consumers if they were fully informed, if there were no costs associated with the negotiation of terms, and markets were fully competitive (i.e., in a 'perfect' market). Others favour redistribution of wealth from sellers to buyers and seek to achieve that end through regulation of SFK terms. Finally some commentators explicitly favour what I will call social planning objectives, by which consumers are required to purchase certain protection through SFKs, even though sellers will charge extra for this protection and there will be no wealth transfer from sellers to buyers as a result of the transaction.

28. Replicating the results of a perfect market is necessarily the goal of any effort to use the market as a regulator of SFK terms. In literature about general contract law commentators often advocate replicating the bargains that would be reached in a perfect

<sup>42</sup> Earlier drafts of the UCC provided more clear rules which were applicable to consumer transactions, but most of them were deleted before final promulgation of the model statute. See LEFF, "Unconscionability and the Code - The Emperor's New Clause", *op. cit.* 24, at 518.

<sup>43</sup> For analogous reasons it has recently been forcefully argued that it is better to regulate rates in lending contracts under the unconscionability principle than under usury statutes. See S. BENDER, *op.cit.* note 26.

market when setting 'default' terms - i.e., those terms that will be implied into a contract in the absence of an agreement to the contrary. The purpose is to save transaction costs, by having default terms replicate what the largest number of contracts would include if bargained and thus saving as many contracting parties as possible the expense of actually negotiating the terms. In the context of SFKs this strategy would suggest regulation setting terms for contracts that replicates the regulator's best guess of what a perfect market would produce, and then, because there rarely is real bargaining about the terms of SFKs, making it very difficult for the parties to deviate from those legislated terms.

Recently Ian Ayres and Robert Gertner have suggested a different strategy for replicating the results of a perfect market through establishing default terms. They suggest that sometimes the default term should be set so as to disadvantage the party with better information or in the stronger bargaining position, unless the default term is replaced by a bargained term. The purpose for establishing such 'penalty defaults' is to give a party in a good position to initiate bargaining an incentive to do so. A bargained term that is tailored to the situations of the parties can be more desirable than any default term.<sup>44</sup>

The Ayres/Gertner approach can account for a good deal of regulation of SFKs that appears to be pro-consumer in intent. It is common for statutes to imply a term into a SFK and provide that it can be displaced only if the substitute term meets certain formal requirements, which seem designed to insure that the consumer notices the substitute term. For example, the Uniform Commercial Code provides for broad implied warranties of quality in sale of good transactions, with generous remedies for default. But it also allows a SFK to substitute a no warranty provision providing the substitute (called a disclaimer of warranties) is 'conspicuous', and to modify the remedies for default.<sup>45</sup> I doubt that the generous warranties provided by the Code are ones that well informed parties would negotiate in a perfect market - they are too broad and the remedies are far too generous. But the effect is to put the onus on seller to insure there is an agreement for more restrictive terms, utilising the Ayres/Gertner approach to setting default terms to achieve that end.<sup>46</sup>

29. A great deal of commentary on SFK term regulation identifies the goals of redressing superior bargaining power, disgorging sellers of their 'monopoly' profits, and so forth. Such commentary suggests that the regulatory objective is the redistribution of wealth from sellers to buyers.

<sup>44</sup> I. AYRES & R. GERTNER, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules", 99 *Yale L.J.* 87 (1989).

<sup>45</sup> Uniform Commercial Code §§2-314 to 2-316, 2-719.

<sup>46</sup> Since the formal prerequisites to enforceability of substitute terms are so slight, I doubt that in practice these provisions of the Uniform Commercial Code succeed in producing written terms in SFKs that replicate the conditions which a perfect market would produce. Sellers are able to satisfy these formal requirements without truly involving buyers in informed decision-making. As a result I am inclined to characterise these provisions of the Code as symbolic legislation - an enactment that appears to favour consumer interests without truly benefiting consumers in any significant sense. See *supra* notes 40-41 and accompanying text.



It is my basic thesis that this kind of redistribution is rarely possible through regulation of SFK terms.<sup>47</sup> Regulation of SFK terms rarely includes regulation of prices. Sellers can simply increase the price of the good or service to account for the extra costs to them of the SFK term regulation. Since all sellers are normally subject to the regulation, competitive forces do not normally foreclose price increases.<sup>48</sup>

30. The kind of redistribution that can be achieved through SFK term regulation is between consumers, not from seller to buyer. Any mandated SFK term will benefit some consumers more than others. For example a prohibition of clauses excluding tort damages benefits only those who are injured in a way which gives rise to tort liability. If sellers raise prices to cover the costs to them of the mandated SFK term, the regulation can be seen as a kind of compulsory insurance, with consumers who do not benefit directly from the insurance, because they are not injured,<sup>49</sup> nonetheless paying higher prices and in effect subsidising those who receive the insurance benefits. This kind of redistribution between consumers is a feature of almost all regulation containing what I will refer to as social planning objectives.

31. American law mandates many terms in SFKs, terms that cannot be varied by agreement. There is often an academic dispute about whether a particular mandated term reflects an objective of replicating what would exist in a perfect market. It is always possible to argue in such circumstances that the mandated terms are an estimate of the agreement that would be reached in a perfect market, and that it is not possible to allow parties to modify the mandated term in a SFK because no agreement in that form can be a knowing one. I do not believe, however, that many mandated term provisions can be justified as legitimate efforts to replicate the results of a perfect market. Rather they represent the substitution of the law-maker's judgement for that of the parties as to what is in the parties' best interests.<sup>50</sup>

In contemporary academic literature social planning is most commonly justified as a regulatory objective on the ground that consumer judgments are systematically biased in certain respects, no matter how much information is available and understood. For example, many people believe that in making purchasing decisions large numbers of consumers will overly discount long term risk and attach excessive importance to

<sup>47</sup> My analysis in this paragraph is drawn extensively from D. KENNEDY, "Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power", 41 *Md. L. Rev.* 563 (1982).

<sup>48</sup> Price theory suggests that there are some circumstances in which sellers could not pass on all the costs of SFK term regulation. If pre-regulation prices were at or close to the monopoly price for the good or service, it may be maximising for sellers to absorb some of the increased costs rather than pass them all on to consumers. Moreover, in some situations there will be a close substitute to the good or service which is not subject to the SFK term regulation. Then regulated sellers may choose to absorb some of the extra costs as reduced profits rather than lose sales to competitors. I believe, however, that in the vast majority of instances all or most of the costs to sellers of mandated terms in SFKs are passed on to buyers in the form of higher prices.

<sup>49</sup> Even in the absence of direct payouts in their favour, consumers can receive some benefits from mandated insurance. Most directly, they may choose to forego purchase of substitute insurance, saving the premiums. The consumer may also have greater peace of mind.

<sup>50</sup> Others have come to similar conclusions about the rationale for much mandated term regulation. D. KENNEDY, *op.cit.* note 47; T. Kronman, "Paternalism in the Law of Contract", 92 *Yale L.J.* 763.

short term gain. Consequently, consumers need to be protected from themselves - for example, by preventing them from agreeing to exclude any seller tort liability in return for a modest but immediate reduction in price.

There have been some efforts to test hypotheses about the fallibility of consumer judgement through carefully controlled laboratory experiments testing consumer decision-making.<sup>51</sup> While such experiments are useful, it is unlikely that the question whether regulation can justifiably pursue social planning objectives will ever be reduced to an empirical science. For one thing, the most these experiments can ever show is that some consumers make fallible judgements. There will always be consumers who lack this judgmental disability and who would prefer, if fully informed, to waive the benefits of the mandated term. Mandated term regulation can never be pareto optimal, therefore, and lacking any technique for making interpersonal comparisons of utility it will never be possible to empirically contrast the benefits to fallible consumers against the costs to other consumers. Rather the decision to pursue social planning objectives will need to be based on value judgments, such as the desirability of favouring the interests of needy consumers over the interests of those in better economic circumstances.

<sup>51</sup> See D. KAHNEMAN, P. SLOVIC & A. TVERSKY, *Judgment Under Uncertainty: Heuristics and Biases*, Cambridge Univ. Press, 1982. A good summary of this work and a discussion of its applicability to economic analysis can be found in B. FREY, *Economics As a Science of Human Behaviour*, ch. 11 (Kluwer Academic Publishers, 1992).