Proportional Contracts

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ABSTRACT: Contract law treats consumer attention as if it were unlimited. We instead view consumer attention as a scarce resource that must be conserved. We argue that consumer contracts generate negative externalities by overwhelming consumers with information that depletes their attention and prevents competition on contract terms. We propose a novel solution to this market failure: To force sellers to internalize the attention externalities that their contracts generate. This will be accomplished through a Pigouvian tax on the presentation of a consumer contract, proportionate to the attention costs that reading and comprehending the contract would impose on consumers.

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I. INTRODUCTION

Nobel-prize winning economist Herbert Simon once observed, "information . . . consumes the attention of its recipients. . . . Hence a wealth of information

creates a poverty of attention . . . ."[1] In a market economy, sellers compete for consumers' attention. While the supply of each consumer's attention remains constant,[2] demand for consumer attention continues to grow as specialization, complexity, and expanding options for products and services pressure consumers to process ever more information.[3] This information overload, in turn, exacerbates consumers' attention deficit.[4]

Attention is a limited resource.[5] It can be exhausted or depleted. In addition, attention is becoming increasingly scarce, as information and other stimuli proliferate.[6] When attention is depleted, performance on cognitive tasks declines dramatically.[7] In one dramatic demonstration of this proposition, performance artist and consultant Apollo Robbins used attention overload and misdirection to remove cash, a wrist watch, and a poker chip from an audience member; changed his own clothing; and planted a shrimp cocktail in a man's pocket without the massive audience noticing.[8]

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1. Herbert A. Simon, *Designing Organizations for an Information-Rich World*, *in* COMPUTERS, COMMUNICATIONS, AND THE PUBLIC INTEREST, 37, 40 (Martin Greenberger ed. 1971).

2. Household attention to *consumption* decisions may even be falling over time as women increasingly find employment outside the home, while typically remaining the principal decision-makers regarding household consumption. *See Employment-Population Ratio - Women*, FED. RSRV. ECON. DATA, https://fred.stlouisfed.org/series/LNS12300002 [https://perma.cc/LS2M-58EY]; Michael J. Silverstein & Kate Sayre, *The Female Economy*, 87 HARV. BUS. REV. 46, 50, 53 (2009) ("Women make the decision in the purchases of 94% of home furnishings . . . 92% of vacations . . . 91% of homes . . . 60% of automobiles . . . 51% of consumer electronics . . . . [W]omen don't make enough time for themselves. They are still far more burdened than men by household tasks . . . .").

3. Lisbet Berg & Åse Gornitzka, *The Consumer Attention Deficit Syndrome: Consumer Choices in Complex Markets*, 55 ACTA SOCIOLOGICA 159, 160 (2012).

4. *Id.*; *see also generally* BARRY SCHWARTZ, THE PARADOX OF CHOICE: WHY MORE IS LESS (Harper Collins rev. ed. 2009) (discussing the psychological pitfalls of growing consumer choice).

5. *See generally* DANIEL KAHNEMAN, ATTENTION AND EFFORT (1973) (discussing the relationship between attention and effort, explaining that people need to exert effort to pay attention).

6. *See generally* THOMAS H. DAVENPORT & JOHN C. BECK, THE ATTENTION ECONOMY: UNDERSTANDING THE NEW CURRENCY OF BUSINESS (2001) (outlining how businesses need to adapt to increased workplace distractions to maintain productivity); Nikolas Guggenberger, *Online Speech And The Attention Tragedy* 10–13 (unpublished manuscript) (2021) (on file with authors).

7. *See generally* SENDHIL MULLAINATHAN & ELDAR SHAFIR, SCARCITY: WHY HAVING TOO LITTLE MEANS SO MUCH (2013) (explaining how attention scarcity impedes people's cognitive abilities and adversely affects their decision-making processes); Anuj K. Shah, Eldar Shafir & Sendhil Mullainathan, *Scarcity Frames Value*, 26 PSYCH. SCI. 402 (2015) (noting how people more closely resemble rational actors when allocating attention scarcity efficiently); Jiaying Zhao & Brandon M. Tomm, *Psychological Responses to Scarcity*, OXFORD RSCH. ENCYCLOPEDIA PSYCH. (Feb. 26, 2018), https://oxfordre.com/psychology/view/10.1093/acrefore/9780190236557.001.0001/acrefore-9780190236557-e-41 [https://perma.cc/H7F6-YC2M] (discussing how scarcity of attention as a resource affects the poor).

8. Adam Green, *A Pickpocket's Tale: The Spectacular Thefts of Apollo Robbins*, NEW YORKER (Dec. 30, 2012), https://www.newyorker.com/magazine/2013/01/07/a-pickpockets-tale

Sellers may purchase consumers' attention by buying advertisements on a variety of consumer service platforms.[9] However, because sellers must pay in exchange for advertising space, they are inherently limited in the amount of consumer attention they can exhaust.[10] At the same time, sellers do not have to pay for consumer attention to contractual terms, regardless of their length or complexity. This is because a signed contract legally binds a consumer, irrespective of the amount of attention required to understand its legal implications. In addition, courts enable sellers to bind consumers to unread contracts through liberal application of the "duty to read" doctrine.[11] This approach effectively treats consumer attention as unlimited, when it is in fact scarce.

Sellers tend to benefit when consumers *do not* pay attention to form contracts, which are often stuffed with pro-seller terms encoded in complex legal jargon.[12] Sellers can use organizational advantages and economies of scale to overwhelm consumers with contractual detail.[13] Traditional justifications for enforcement of contracts typically rely on the notion that contracts are the product of mutual agreement and that private ordering improves social welfare.[14] Yet, consumers often cannot provide informed consent because they encounter more contracts and provisions than is practicable for them to read, let alone comprehend.[15]

Contract law has yet to adapt to consumers' contracting reality. Because consumers' attention is so depleted, market competition cannot sufficiently constrain sellers from inserting inefficient, one-sided terms into standardized agreements.[16] Current regulation provides limited relief. Subject to a few consumer-protective regulations, the law generally empowers sellers to set the

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[https://perma.cc/T5UH-M3P4]; TED, *The Art of Misdirection | Apollo Robbins*, YOUTUBE (Sept. 13, 2013), https://www.youtube.com/watch?v=GZGYowPAnus [https://perma.cc/5MWX-CXNB].

9. *See generally* TIM WU, THE ATTENTION MERCHANTS: THE EPIC SCRAMBLE TO GET INSIDE OUR HEADS (1st ed. 2017) (discussing the variety of ways in which companies seek to gain consumers' attention).

10. *See* VINCENT F. HENDRICKS & MADS VESTERGAARD, REALITY LOST: MARKETS OF ATTENTION, MISINFORMATION AND MANIPULATION 6–11 (Sara Høyrup trans., 2019).

11. *See* Section II.C, *infra*.

12. *See* Section II.D, *infra*.

13. This is because sellers only need to draft a contract once and can reuse it with many consumers (while improving and updating it over time).

14. *See, e.g.*, ROY KREITNER, CALCULATING PROMISES: THE EMERGENCE OF MODERN AMERICAN CONTRACT DOCTRINE 1–3 (2007); STEVEN SHAVELL, FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW 296–99 (2004); CHARLES FRIED, CONTRACT AS PROMISE: A THEORY OF CONTRACTUAL OBLIGATION 7–10 (2015); HANOCH DAGAN & MICHAEL HELLER, THE CHOICE THEORY OF CONTRACTS 25–28 (2017); Daniel Markovits, *Contract and Collaboration*, 113 YALE L.J. 1417, 1477–81 (2004); and Jonathan R. Macey, *Public and Private Ordering and the Production of Legitimate and Illegitimate Legal Rules*, 82 CORNELL L. REV. 1123, 1125 (1997).

15. *See infra* notes 36–41 and accompanying text.

16. *See infra* Section II.D.1.; *see also generally* Albert Choi & George Triantis, *The Effect of Bargaining Power on Contract Design*, 98 VA. L. REV. 1665 (2012) (examining the impact of uneven bargaining power on non-price terms to a contract).

rules unilaterally and bind consumers to their "agreements" without consumers knowing what they have agreed to.[17]

Some regulations intended to address this problem include mandatory disclosures,[18] heightened notice requirements,[19] and more cumbersome processes for opt-outs from legislative defaults.[20] Yet, these solutions often instead exacerbate the problem by demanding even more time and attention from consumers.[21]

More fundamentally, perhaps, these solutions have failed because they neglected to address the underlying problem: over-exploitation of a limited resource.

Every demand on consumer attention depletes that attention and reduces consumers' ability to assess competing contracts.[22] This "breaks" the market for contractual terms.[23] Imagine a perfect scenario in which all consumers read and understand all contractual terms. In this scenario, consumer feedback towards sellers will lead sellers to adopt efficient terms, which will be pro-consumer when the benefits to consumers are greater than the costs to sellers. Overall, the contract will likely be relatively balanced between the interests of consumers and sellers. Now imagine that sellers make their contracts so long and complicated that most consumers stop reading them. Consumers may suspect that contractual terms have generally become less favorable to them. However, consumers will not know how unfavorable contractual terms have become; nor will they be able to tell which sellers have made their contracts more unfriendly to consumers. In this state of the world, consumers cannot distinguish between sellers with varying contract quality, and sellers have incentives to use ever more pro-seller terms because they can do so without any penalty.[24]

If some consumers do read and others do not, but sellers cannot distinguish between them and therefore provide them all with the same form contract, then consumers' fate will be linked to one another's behavior. In

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17. *See infra* Section II.D.3.

18. *See, e.g.*,OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE 3–4 (2014).

19. Florencia Marotta-Wurgler, *Will Increased Disclosure Help? Evaluating the Recommendations of the ALI's "Principles of the Law of Software Contracts"*, 78 U. CHI. L. REV. 165, 168 (2011).

20. Lauren E. Willis, *When Nudges Fail: Slippery Defaults*, 80 U. CHI. L. REV. 1155, 1224 (2013).

21. *See, e.g.*, BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 22–25.

22. Berg & Gornitzka, *supra* note 3, at 161–63; SCHWARTZ, *supra* note 4, at 2–3; Hazel Rose Markus & Barry Schwartz, *Does Choice Mean Freedom and Well-Being?*, 37 J. CONSUMER RSCH. 351 –55 (2010).

23. *See, e.g.*, Lawrence M. Ausubel, *The Failure of Competition in the Credit Card Market*, 81 AM. ECON. REV. 68–70 (1991); MICHAEL J. TREBILCOCK, THE LIMITS OF FREEDOM OF CONTRACT 102 –26 (1997).

24. *Cf.* Henry Hansmann, *Cooperative Firms in Theory and Practice*, 1999 FINNISH J. BUS. ECON. 387, 389–90, 395–96 (arguing that consumer-owned cooperatives can sometimes overcome contracting costs, information asymmetries and market failure, but that technological change and product market differentiation nevertheless limit cooperatives' economic importance).

particular, if a critical mass of consumers reads and understands contractual terms, and either declines to transact, negotiates, or shops around for better terms, then sellers will be encouraged to offer all consumers more buyer-friendly terms. The portion of consumers who read versus those who do not read may ultimately determine the deal that all consumers get. Thus, each consumer's decision generates externalities that affect other consumers. Note that there is no way for consumers to protect themselves from these negative externalities. A consumer who transacts when contractual terms are unfavorable will (in expectation) be harmed by the anti-consumer contractual terms. A consumer who declines to transact after reading the contract will also be harmed because that consumer will not have the opportunity to transact under the favorable terms that would have existed if all consumers read the contract.[25]

Since every contract (and especially a complicated contract) depletes consumers' attention and reduces the likelihood that consumers will read contracts, a consumer contract, by its very existence, generates a negative externality that should be regulated. Ultimately, by making their contracts too complicated for consumers to read, breaking the competitive market, and freeing all sellers to adopt anti-consumer terms, it is the sellers that create these negative externalities and profit from them. Yet, theories grounded in freedom of contract have so far ignored the negative externalities generated by consumer contracts. Instead of recognizing that consumer attention is a scarce resource that should be conserved, current doctrine and practice treat consumer attention as if it were unlimited.[26]

We propose a fundamental shift in the framework for regulating consumer contracts. This new framework would recognize consumer attention as a scarce common resource, and contractual complexity as imposing negative externalities. The goal of this framework is to conserve consumer attention, thereby harnessing it to increase the competitiveness of terms in standardized contracts. To accomplish this, we propose to force sellers to internalize the attention costs they impose on consumers through Pigouvian taxation.[27] Pigouvian taxation is a widely recognized method of

25. Consumers' decisions not to transact will also harm sellers, but in aggregate sellers will be better off because the rents that they extract from the consumers who transact on unfavorable terms exceed the loss of profit as a result of some consumers' failure to transact. If this were not the case, then sellers would adopt more consumer-friendly contracts.

26. *See infra* Section II.C.

27. A Pigouvian tax is a tax proportional to the harm that a firm imposes on third parties. This ensures that the firm engages in the externality-generating activity only to the extent that the value of this activity to the firm exceeds the harm to third parties, such that the social value of those activities is positive. *See generally* A. C. PIGOU, THE ECONOMICS OF WELFARE (1920); *see also* William J. Baumol, *On Taxation and the Control of Externalities*, 62 AM. ECON. REV. 307, 307, 311 (1972).

regulating externality-generating activities.[28] In fact, according to most economists, it is the optimal method to regulate externalities.[29]

Our approach consists of two parts. First, we propose to tax sellers based on the attention costs they impose on consumers when presenting contracts to them.[30] This Pigouvian tax will rise in proportion to the amount of consumer attention sellers use up.[31] We develop mechanisms to estimate the costs to consumers of paying attention to contracts.[32] If our proposal is adopted, the costs to sellers of contractual complexity will rise. To reduce these newly internalized costs, sellers will have to draft shorter and simpler contracts.

Second, we propose that gaps resulting from leaner contracts would be filled with default rules. These defaults would be crafted through political processes in which both businesses and consumers have representation. Because the aforementioned tax would raise sellers' costs of deviating from defaults, sellers would be incentivized to participate in the default-crafting process. As defaults become stickier, consumer advocates would similarly have strong incentives to participate in the default drafting process. We expect that defaults will be more carefully designed and will gradually become more efficient as a result.

As contracts shrink, reading by consumers would become more practicable. With shorter, simpler contracts, any included terms could potentially become salient and a competitive market for contractual terms could emerge. With real competition over terms and Pigouvian taxation of firms for the depletion of consumer attention, contractual complexity would

28. Jonathan S. Masur & Eric A. Posner, *Toward a Pigouvian State*, 164 U. PA. L. REV. 93, 100–01 (2015).

29. *See infra* notes 191–92 and accompanying text.

30. Attention is generally defined as "the act or state of applying the mind to something." *Attention*, *Merriam-Webster*, https://www.merriam-webster.com/dictionary/attention?utm_campaign=sd&utm_medium=serp&utm_source=jsonld [https://perma.cc/9S2S-N9ZQ]. It is also defined as "focused mental engagement on a particular item of information." DAVENPORT & BECK, *supra* note 6, at 20.

31. We also consider other regulatory approaches to conserving consumer attention, such as "cap & trade" or "command and control." However, these approaches require that regulators conduct a cost-benefit analysis to determine whether the benefits of alleviating the externalities for consumers exceed the harms caused by capping or preventing firms' use of customized contracts. This means that regulators will need to have detailed knowledge of the *social benefits* of customizing contracts or the optimal length and complexity of any given contract. By contrast, the Pigouvian approach requires considerably less information. *See* Masur & Posner, *supra* note 28, at 95 (observing that "[a] perfectly conducted cost-benefit analysis should produce results as efficient as a Pigouvian tax, but in a world of administrative costs, command-and-control regulation will be inferior."). Since Pigouvian taxation only demands that regulators estimate individual attention costs for a given contract, our discussion focuses on the more administrable solution.

32. *See infra* Section III.B.1.

fall from the level that is profit-maximizing for sellers to a level that is efficient, taking into account the well-being of consumers and sellers alike.

Our proposed two-pronged reform would likely result in more efficient contracts, both because the explicit contract terms would become salient to consumers and because the incorporated defaults would be products of a more inclusive and deliberative process than unliterally drafted provisions.

This Article proceeds as follows. In Part II, we explain why consumer attention should be viewed as a scarce common resource. We survey evidence that consumers do not pay attention to contractual terms and explain why this is a problem. We show that current regulatory solutions are partial and sometimes counterproductive because policymakers fail to treat consumer attention as a limited resource. Part III presents our proposed solution: To tax sellers for the attention costs their contracts impose on consumers and fill resultant contractual gaps with carefully crafted default rules. In Part IV we explain how our proposal could complement current efforts to protect consumers. Part V concludes.

II. THE PROBLEM: CONSUMER ATTENTION IS A SCARCE RESOURCE

Attention scarcity is closely related to time scarcity: The busier we are, the more limited our attention becomes.[33] When we focus our attention on one thing, we neglect others.[34] As businesses offer ever more products and services, the information environment becomes increasingly saturated with content, and consumers' attention deficit keeps growing.[35]

Since consumer attention is a valuable and scarce resource, sellers compete for it.[36] As markets for attention have emerged, so have the terms "attention economy" and "attention merchants."[37] In the attention economy, consumers and sellers have flipped their traditional roles: consumers have become the *suppliers* of attention, while sellers *demand* it.

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33. Admittedly, time and attention are distinct: one can spend a lot of time on something without focusing their attention on it, while a fleeting event or experience can be "attention-grabbing". *See, e.g.*, Nina Koiso-Kanttila, *Time, Attention, Authenticity and Consumer Benefits of the Web*, 48 BUS. HORIZONS 63, 65 (2005). Yet, since time and attention are often related, time is often used as a proxy for attention. *See* DAVENPORT & BECK, *supra* note 6, at 27.

34. Mullainathan and Shafir refer to the negative consequences of focusing as "the tunneling tax." MULLAINATHAN & SHAFIR, *supra* note 7, at 35–38; Erich Muehlegger & Daniel Shoag, *Cell Phones and Motor Vehicle Fatalities*, 78 PROCEDIA ENG'G (2014) 173, 176 (finding evidence that divided attention during driving increases car accidents four-fold).

35. *See, e.g.*, EYAL ZAMIR & DORON TEICHMAN, BEHAVIORAL LAW AND ECONOMICS 173–74 (2018) (noting that people suffer from "information overload" and surveying the relevant literature); Berg & Gornitzka, *supra* note 3, at 159–75. For a discussion about how the "accumulation" of mandatory disclosures is overwhelming consumers, see BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 94–95, 101 (2014); George Loewenstein, Cass R. Sunstein & Russell Golman, *Disclosure: Psychology Changes Everything*, 6 ANN. REV. ECON. 391, 398–400 (2014).

36. DAVENPORT & BECK, *supra* note 6, at 9 ("As with any other scarce and valuable resource, markets for attention exist both within and outside an organization.").

37. DAVENPORT & BECK, *supra* note 6; WU, *supra* note 9, at 16, 53.

But consumers' attention does not grow with demand. Indeed, it may even shrink if there are fewer household members available to attend to consumption decisions.[38] As a result, relevant information is increasingly overlooked, and additional information often provides limited, if any, benefits.[39]

A. *CONSUMERS DO NOT PAY ATTENTION TO CONTRACTS*

Given consumers' attention deficit, it is not surprising that consumers rarely read standard form contracts.[40] Consumers encounter an enormous amount of fine print every day, and it is not practical to read all of these contracts thoroughly.[41]

In a study of readership, Yannis Bakos, Florencia Marotta-Wurgler, and David Trossen tracked the browsing behavior of more than 40,000 consumers.[42] They found that consumers often fail to access online software's "terms and conditions" webpage, and that those who do spend very little time reviewing these terms.[43] They also found that requiring buyers to click "I agree" to the terms of the agreement before finalizing a purchase increased reading by only 0.36 percent.[44]

B. *WHY DON'T CONSUMERS PAY ATTENTION TO CONTRACTS?*

Consumers' failure to read the fine print is mainly attributed to the high attention costs that contract readership requires. One study estimated that if consumers were to read every privacy policy to which they agreed, it would

38. *See, e.g.*, CARL SHAPIRO & HAL R. VARIAN, INFORMATION RULES: A STRATEGIC GUIDE TO THE NETWORK ECONOMY 6 (1998) ("Nowadays the problem is not information access but information overload."); *see* HENDRICKS & VESTERGAARD, *supra* note 10 at 1, 3–4; *see* Silverstein & Sayre, *supra* note 2, at 48–49 (discussing women entering the workforce while retaining responsibility for many household consumption decisions).

Indeed, in the United States, the average number of adults per household shrank from the 1940s through 2010. U.S. CENSUS BUREAU, HISTORICAL HOUSEHOLD TABLES: TABLE HH-6. AVERAGE POPULATION PER HOUSEHOLD AND FAMILY: 1940 TO PRESENT, https://www.census.gov/data/tables/time-series/demo/families/households.html [https://perma.cc/D3NM-PFA4].

39. *See, e.g.*, BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 64–67.

40. *See, e.g.*, KLEIMANN COMMC'N GRP., INC., KNOW BEFORE YOU OWE: EVOLUTION OF THE INTEGRATED TILA-RESPA DISCLOSURES 7, 25 (2012), https://files.consumerfinance.gov/f/201207_cfpb_report_tila-respa-testing.pdf [https://perma.cc/M3E5-9WMX] ("[C]onsumers will rarely read [credit agreements] unless they are highly motivated—and most consumers experience information overload with the volume and complexity of loan and real estate processes."); Jonathan A. Obar & Anne Oeldorf-Hirsch, *The Biggest Lie on the Internet: Ignoring the Privacy Policies and Terms of Service Policies of Social Networking Services*, 23 INFO. COMMC'N & SOC'Y 128, 129–30, 135 (2020) (finding that 74 percent of participants in an online experiment ignored privacy policies of social networking services, and others barely read).

41. *See, e.g.*, Ian Ayres & Alan Schwartz, *The No-Reading Problem in Consumer Contract Law*, 66 STAN. L. REV. 545, 546 (2014).

42. Yannis Bakos, Florencia Marotta-Wurgler & and David R. Trossen, *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. LEGAL STUD. 1, 1 (2014).

43. *Id.*

44. Marotta-Wurgler, *supra* note 19, at 179–81 (2011).

take them an average of 244 hours each year, amounting to $781 billion in lost productivity.[45] Thus, it may be rational for consumers to adopt a strategy of terms-ignorance to economize on the use of their time and attention.[46]

Consumers often intuit that the costs of reading and comprehending standardized agreements are likely to exceed the benefits.[47] Many consumers are not literate or numerate enough to understand the meaning of sellers' contractual terms or could only understand these terms with an unreasonable amount of effort.[48] Even literate and well-educated consumers routinely fail to read form agreements because the costs of reading *all of* them remain high relative to the potential benefits of negotiation or comparison shopping for better terms.[49]

Even if consumers were to read the terms, many of them would not *understand* their meaning and implications. Consumer contracts are often drafted in complex legal jargon, and understanding their provisions often requires expertise that consumers lack.[50] Nor do individual consumers have the economies of scale or built-in collective organization that could make legal counsel affordable.[51]

A study conducted by Uri Benoliel and Shmuel Becher found that online "terms and conditions" are often unreadable.[52] Indeed, 99.6 percent of the sampled contracts were written at a level of difficulty that would make them incomprehensible to most consumers.[53] According to the researchers, "the average readability level of these agreements is comparable to . . . articles in academic journals."[54]

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45. Aleecia M. McDonald & Lorrie Faith Cranor, *The Cost of Reading Privacy Policies*, 4 I/S: J.L. & POL'Y FOR INFO. SOC'Y 543, 563–64 (2008).

46. *See, e.g.*, Richard A. Epstein, *Contract, Not Regulation: UCITA and High-Tech Consumers Meet Their Consumer Protection Critics*, *in* CONSUMER PROTECTION IN THE AGE OF THE 'INFORMATION ECONOMY' 205, 227 (Jane K. Winn ed., 2006); Avery Katz, *Your Terms or Mine? The Duty to Read the Fine Print in Contracts*, 21 RAND J. ECON. 518, 521 (1990).

47. *See, e.g.*, ZAMIR & TEICHMAN, *supra* note 35, at 10; Robert Prentice, *Contract-Based Defenses in Securities Fraud Litigation: A Behavioral Analysis*, 2003 U. ILL. L. REV. 337, 358–62 (2003).

48. *See* Alan M. White & Cathy Lesser Mansfield, *Literacy and Contract*, 13 STAN. L. & POL'Y REV. 233, 235–42 (2002).

49. Katz, *supra* note 46, at 526–27; Tess Wilkinson-Ryan, *The Perverse Consequences of Disclosing Standard Terms*, 103 CORNELL L. REV. 117, 123 (2017); For a similar argument in the context of disclosures, see BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 94–95, 101.

50. *See, e.g.*, BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 86; Uri Benoliel & Shmuel I. Becher, *The Duty to Read the Unreadable*, 60 B.C. L. REV. 2255, 2289–93 (2019).

51. *See* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1223–25 (1983); Friedrich Kessler, *Contracts of Adhesion—Some Thoughts about Freedom of Contract*, 43 COLUM. L. REV. 629, 632–33 (1943).

52. Benoliel & Becher, *supra* note 50, at 2282–84.

53. *Id.* at 2279.

54. *Id.* at 2277–78.

Consumers are often reluctant (or unable) to hire professional experts (e.g., lawyers) to help them understand contracts.[55] Difficulty reading therefore means that consumers would face high attention costs if they sought to become informed. These costs often discourage consumers from reading, leading sellers to adopt one-sided terms. These terms are typically not merely harmful to consumers, but are also welfare-reducing overall.[56]

C. *CONTRACT LAW PLACES UNREASONABLE DEMANDS ON CONSUMERS' ATTENTION*

Contract law's "duty to read" doctrine imposes on contracting parties an obligation to read and understand contracts.[57] If a party signs a contract, the party is deemed to have knowingly agreed to its terms. Failure to read the agreement does not vitiate consent: Contracting parties constructively agree to the terms of contracts they enter into as long as they were given the opportunity to review these terms before signing.[58] Parties may choose to disregard this duty by not reading, or to fulfill it with only modest attention, but by doing so they assume the risk that they will be subsequently surprised by the terms of the agreement.[59]

Courts routinely rely on the "duty to read" in enforcing consumer contracts.[60] As the U.S. Supreme Court stated, "[a] contractor must stand by

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55. *See* Rebecca L. Sandefur, *Money Isn't Everything: Understanding Moderate Income Households' Use of Lawyers' Services*, *in* MIDDLE INCOME ACCESS TO JUSTICE 222, 222–23 (Michael Trebilcock, Anthony Duggan & Lorne Sossin eds., 2012).

56. *See* Peter A. Diamond, *A Model of Price Adjustment*, 3 J. ECON. THEORY 156, 157 (1971); Steven Salop & Joseph Stiglitz, *Bargains and Ripoffs: A Model of Monopolistically Competitive Price Dispersion*, 44 REV. ECON. STUD. 493, 495 (1977).

57. For a more detailed exposition of the doctrine, see generally Stewart Macaulay, *Private Legislation and the Duty to Read—Business Run by IBM Machine, the Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051 (1966) (discussing the background and rationale for the duty to read doctrine and applying it to credit card contracts); John D. Calamari, *Duty to Read—A Changing Concept*, 43 FORDHAM L. REV. 341 (1974) (on the traditional doctrine, traditional exceptions, and the modern approach to contracts of adhesion); Katz, *supra* note 46 (analyzing consumer incentives to read form contracts); Charles L. Knapp, *Is There a "Duty to Read?"*, 66 HASTINGS L. J. 1083 (2015) (contextualizing the duty to read among principles of contract law); and Benoliel & Becher, *supra* note 50 (finding through empirical analysis "that consumer sign-in-wrap contracts are generally unreadable" and recommending policy changes).

58. See sources cited *supra* note 57.

59. *See, e.g.*, Calamari, *supra* note 57, at 341.

60. *E.g.*, Ayres & Schwartz, *supra* note 41, at 548 n.9; Knapp, *supra* note 57, at 1085. For representative cases, see *John Hancock Mut. Life Ins. Co. v. Yates*, 299 U.S. 178, 180 (1936) ("[W]hen the insured receives a policy, it is his duty to read it or have it read . . . ."); THI of N.M. at Vida Encantada, LLC v. Lovato, 848 F.Supp.2d 1309, 1325 (D.N.M. 2012) ("Each party to a contract . . . has a duty to read and familiarize herself with its contents before signing it . . . ." (quoting THI of N.M. at Hobbs Ctr., LLC v. Patton, Civ. No. 11–537 (LH/CG), 2012 WL 112216, *22 (D.N.M. Jan. 3, 2012)); Rosenfeld v. JPMorgan Chase Bank, N.A., 732 F.Supp.2d 952, 965 (N.D. Cal. 2010) ("Plaintiff has a duty to read the terms of a contract before signing."); Heller Fin., Inc. v. Midwhey Powder Co., 883 F.2d 1286, 1292 (7th

the words of his contract; and, if he will not read what he signs, he alone is responsible for his omission."[61] Refraining from reading the contract does not constitute grounds for voiding it,[62] nor does it enable a contracting party to reform the contract based on mistake.[63] The "duty to read" doctrine can be described as contract law's analog to the "assumption of risk" doctrine in tort law. A contracting party who neglects to read the contract prior to signing assumes the risk of being bound by any unfavorable terms discovered *ex post*.[64]

The "duty to read" is rooted in ideals of autonomy and freedom of contract.[65] Under these principles, parties should be free to enter into agreements as they wish, secure in the knowledge that those contracts will later be enforced. If contracting parties have an opportunity to read a contract but choose not to, they should be held accountable for such omissions. Otherwise, they would be depriving their counterparty of the benefits of that agreement.[66]

Arguably the strongest justification for the duty to read is consequentialist: Under certain conditions, imposing such a duty could promote economic efficiency and social welfare.[67] First, imposing a duty to read may encourage contracting parties to read contracts before signing.[68] Encouraging contracting parties (especially non-drafters) to read contracts—or hire lawyers to read contracts for them—could increase the probability that

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Cir. 1989) ("[I]t is no defense to say, 'I did not read what I was signing.'"); Faur v. Sirius Int'l Ins. Corp., 391 F.Supp.2d 650, 658 (N.D. Ill. 2005).

61. Upton v. Tribilcock, 91 U.S. 45, 50 (1875).

62. Williamson v. Pub. Storage, Inc., No. 3:03CV1242, 2004 WL 491058, at *3 (D. Conn. Mar. 1, 2004); MS Credit Ctr., Inc. v. Horton, 926 So.2d 167, 177 (Miss. 2006).

63. *See, e.g.*, RS & P/WC Fields Ltd. P'ship v. BOSP Invs., 829 F.Supp. 928, 969 (N.D. Ill. 1993); B. L. Ivey Constr. Co. v. Pilot Fire & Cas. Co., 295 F.Supp. 840, 845 (N.D. Ga. 1968); LG Mayfield LLC v. U.S. Liab. Ins. Grp., 88 N.E.3d 393, 404 (Ohio Ct. App. 2017); Priore v. State Farm Fire & Cas. Co., No. 99692, 2014 WL 811776, at *3 (Ohio Ct. App. Feb. 27, 2014).

64. Ayres & Schwartz, *supra* note 41, at 549; Jody S. Kraus & Robert E. Scott, *The Case Against Equity in American Contract Law*, 93 S. CAL. L. REV. 1323, 1356–58 (2020) (arguing that *ex post* equitable modification of contracts is obsolete).

65. *See generally* 7 CORBIN ON CONTRACTS §§ 29.8–29.12 (rev. ed. 2002); Randy E. Barnett, *A Consent Theory of Contract*, 86 COLUM. L. REV. 269, 273 (1986).

66. Another argument in favor of imposing a duty to read is that by signing a contract without reading it, the non-reading party is manifesting consent to be bound to terms that can be reasonably expected. *See, e.g.*, KARL N. LLEWELLYN, THE COMMON LAW TRADITION: DECIDING APPEALS 370 (1960); Randy E. Barnett, *Consenting to Form Contracts*, 71 FORDHAM L. REV. 627, 635 (2002).

67. The efficiency basis for the "duty to read" doctrine is often very explicit: "To permit a party when sued on a written contract . . . to admit that he signed it but did not read it . . . would absolutely destroy the value of all contracts." *See* Busching v. Griffin, 542 So. 2d 860, 865 (Miss. 1989) (quoting All. Trust Co. v. Armstrong, 186 So. 633, 635 (Miss. 1939)).

68. *See, e.g.*, Macaulay, *supra* note 57, at 1058 ("If one knows he will be legally bound to what he signs, he will take care to protect himself . . . ."); Shmuel I. Becher, *Asymmetric Information in Consumer Contracts: The Challenge That Is Yet to Be Met*, 45 AM. BUS. L.J. 723, 729 (2008) ("[T]he application of the duty to read provides contracting parties with an incentive to read and understand contracts before entering them.").

contracting parties will only enter into transactions that make them better off.[69] Second, the duty to read could decrease the likelihood that the parties will enter into costly legal disputes about the transaction by providing clarity and predictability regarding contractual interpretation.[70] Relatedly, the irrelevance of evidence regarding (non-)readership streamlines judicial enforcement of contracts *ex post*.[71] Third, knowing that the terms of the deal will be enforced as written provides parties with the incentive to develop innovative contractual terms that adapt to new circumstances.[72]

In view of these justifications, courts often treat the duty to read as a conclusive presumption: "[A] party who signs a written contract is conclusively presumed to know its contents and assent to them."[73] Further, the law presumes that a written agreement supersedes any oral agreement the parties reached prior to reducing their agreement to writing.[74] This presumption is bolstered by the routine inclusion of "integration," "merger," or "entire agreement" clauses, which provide that the written contract contains the entire agreement and that any prior communications between the parties (or their agents, such as salespeople) cannot be relied upon to supplement or alter the contract.[75]

The "duty to read" doctrine applies in cases where consumers signed standardized, take-it-or-leave-it forms without reading.[76] It applies regardless of asymmetries in sophistication, information, or resources between sellers

69. *See, e.g.*, Macaulay, *supra* note 57, at 1058 (stipulating that under the duty to read "more bargains will approach the economists' ideal where both leave the bargaining table in a better position than when the negotiations began.").

70. This predictability may efficiently encourage drafting parties to rely on their contracts, knowing that contracts will be enforced whether or not their contracting parties have read them. *Id.* at 1058 (providing that the duty to read will reduce the chances of dispute because each party would be aware of their obligations and allocations of risk).

71. *See* Katz, *supra* note 46, at 522 ("[W]hen courts assert that the duty to read is more efficient they are usually speaking in terms of their own costs of adjudication and enforcement.").

72. Ronald J. Gilson, Charles F. Sabel & Robert E. Scott, *Contract and Innovation: The Limited Role of Generalist Courts in the Evolution of Novel Contractual Forms*, 88 N.Y.U. L. REV. 170, 180–85 (2013).

73. Bibbs v. House of Blues New Orleans Rest. Corp., No. 10-82, 2011 WL 1838783, at *6 (E.D. La. May 13, 2011). Similarly, courts have consistently held that "a person who signs a contract is presumed as a matter of law to know its terms." *See* D. Wilson Constr. Co. v. McAllen Indep. Sch. Dist., 848 S.W.2d 226, 230 (Tex. App. 1992, writ dism'd w.o.j.).

74. *See, e.g.*, Farina v. Calvary Hill Cemetery, 566 S.W.2d 650, 652 (Tex. Civ. App. 1978, writ ref'd n.r.e.).

75. Justin Sweet, *Contract Making and Parol Evidence Diagnosis and Treatment of a Sick Rule*, 53 CORNELL L. REV. 1036, 1037 (1968); Alan Schwartz & Robert E. Scott, *Contract Interpretation Redux Review*, 119 YALE L.J. 926, 926 (2010); Kevin Davis, *Licensing Lies: Merger Clauses, the Parol Evidence Rule and Precontractual Misrepresentations*, 33 VAL. U. L. REV. 485, 489–90 (1999); Russell Korobkin, *The Borat Problem in Negotiation: Fraud, Assent, and the Behavioral Law and Economics of Standard Form Contracts*, 101 CALIF. L. REV. 51, 64 (2013) [hereinafter Korobkin, *The Borat Problem*].

76. *See, e.g.*, Knapp, *supra* note 57, at 1094.

and consumers;[77] and regardless of the agreement's length, complexity, or stakes.[78] The same deference to the written word that applies to carefully negotiated, high-value contracts memorializing deals between multibillion-dollar enterprises also applies to contracts unilaterally drafted by enterprises and signed by individual consumers.[79]

While courts have begun to recognize that the duty to read creates problems when a contract demands vastly more attention from consumers than consumers should reasonably allocate to it,[80] they have so far relaxed the duty only in limited situations.[81]

D. WHY IS CONSUMER INATTENTION A PROBLEM?

1. The Prevalence of Seller-Friendly Terms Might Lead to a 'Lemons' Problem

Recognizing that consumers rarely pay attention to the fine print, firms can insert one-sided terms into their contracts.[82] If consumers do not read and do not become informed about the terms of the deal, they will not comparison shop for better terms or negotiate the terms of the agreement.[83] As Richard Craswell notes, "if consumers . . . have no information (or only poor information) about the effect of the contract terms used by any individual seller, each seller will . . . have an incentive to degrade the 'quality'

77. *See, e.g.*, Brown v. E.F. Hutton Grp., Inc., 991 F.2d 1020, 1033 (2d Cir. 1993) (holding that allegedly unsophisticated investors' failure to read securities disclosures was "reckless" and precluded them from bringing fraud claim); The doctrine even applies to illiterate and non-English speaking buyers. *See, e.g.*, Johnnie's Homes, Inc. v. Holt, 790 So. 2d 956, 960 (Ala. 2001); Secoulsky v. Oceanic Steam Nav. Co., 112 N.E. 151, 152 (Mass. 1916); St. Landry Loan Co. v. Avie, 147 So. 2d 725, 726, 728 (La. Ct. App. 1962); White & Mansfield, *supra* note 48, at 234.

78. *See, e.g.*, Thigpen v. Locke, 363 S.W.2d 247, 251 (Tex. 1962); Plains Cotton Co-op. Ass'n v. Wolf, 553 S.W.2d 800, 803 (Tex. Civ. App. 1977, writ ref'd n.r.e); Salinas v. Beaudrie, 960 S.W.2d 314, 320 (Tex. App. 1997, no writ); Badie v. Bank of Am., 79 Cal. Rptr. 2d 273, 278–79 (Cal. Ct. App. 1998).

79. *See* Wayne R. Barnes, *Toward a Fairer Model of Consumer Assent to Standard Form Contracts: In Defense of Restatement Subsection 211(3)*, 82 WASH. L. REV. 227, 229 (2007) ("Through a few clicks of the mouse, consumers are agreeing in record numbers to unfavorable, one-sided terms in adhesion contracts.").

80. *See, e.g.*, Scarpato v. Allstate Ins. Co., No. 05-05520, 2007 WL 172341, at *4 (E.D. Pa. Jan. 23, 2007) (quoting Special Jet Servs., Inc. v. Fed. Ins. Co., 643 F.2d 977, 982 (3d Cir. 1981)).

81. Courts have mainly been willing to relax the duty to read in the context of insurance policies, where the expected value of the amount at stake is relatively low (taking into account the low probability of an insurable event occurring). *See, e.g.*, Harold Weston, *Insured's Duty to Read Insurance Policy as Affirmative Defense in Claims Against Insurance Agents and Brokers*, 8 A.L.R.6TH § 2 (2005); Ronen Avraham, *The Economics of Insurance Law—A Primer*, 19 CONN. INS. L.J. 29, 53–56 (2012); Jordan R. Plitt, *A Survey of the Insured's Duty to Read the Insurance Policy After Purchase*, 34 NO. 7 INS. LITIG. REP. 181 (providing examples where the duty to read "narrows or dissipates" in the insurance context) (2012).

82. *See, e.g.*, Ayres & Schwartz, *supra* note 41, at 546; David A. Hoffman, *From Promise to Form: How Contracting Online Changes Consumers*, 91 N.Y.U. L. REV. 1595, 1604–05 (2016).

83. *See, e.g.*, Ayres & Schwartz, *supra* note 41, at 546.

of its terms."[84] Moreover, it may be difficult for a firm to compete by introducing a shorter contract because consumers would still need to read competitors' longer contracts to determine which is better.[85]

Firms typically steer consumers' attention to specific product attributes on which they seek to compete, while encouraging consumers to overlook other, less salient attributes, like the contractual provisions governing the transaction.[86]

One-sided, pro-seller terms may benefit consumers through lower prices if there is sufficient competition.[87] However, even where lower quality means lower prices, consumers who would prefer more favorable contractual terms and would be willing to compensate sellers for providing them, will not find a contract that meets their preferences on the market.[88] This is because attention costs to consumers are too high to support variation in contractual quality which could benefit both consumers and sellers.

Empirical studies suggest that consumers' failure to pay attention to form contracts results in lower-quality terms. For example, Florencia Marotta-Wurgler has found that software contracts typically favor sellers more than the underlying legal rules do.[89] Studies have also found that most privacy policies

84. Richard Craswell, *Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere*, 92 VA. L. REV. 565, 591 (2006). We take "quality" of terms here to refer to the extent to which consumers would find the term attractive and be willing to pay more for the product if they read and understood the terms.

85. In addition, it may not be in sellers' interests to compete on this dimension because competitors can quickly copy the strategy, rendering all sellers collectively worse off and providing no long-term competitive advantage.

86. OREN BAR-GILL, SEDUCTION BY CONTRACT: LAW, ECONOMICS, AND PSYCHOLOGY IN CONSUMER MARKETS 13–16 (2012); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1206, 1255–56 (2003) [hereinafter Korobkin, *Bounded Rationality*]; Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420, 1471–72 (1999).

87. Note, however, that even markets with indicia of competition (i.e., minimal barriers to entry and exit) can exhibit less than perfectly competitive pricing (for example because of complexity and high search costs), such that seller-friendly policy changes can at least partially be retained as rents. *See, e.g.*, Ariel Ezrachi & David Gilo, *Are Excessive Prices Really Self-Correcting?*, J. COMPETITION L. & ECON. 249, 262–63 (2008); Michael Simkovic, *The Effect of BAPCPA on Credit Card Industry Profits and Prices*, 83 AM. BANKR. L.J. 1, 5, 17–21 (2009); Tal Gross, Raymond Kluender, Feng Liu, Matthew J. Notowidigdo & Jialan Wang, *The Economic Consequences of Bankruptcy Reform* 24–25, 34 (Nat'l Bureau of Econ. Rsch., Working Paper No. 26254, 2019), https://www.nber.org/papers/w26254 [https://perma.cc/2JJ2-LEV5].

88. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1206 ("Market competition actually will *force* sellers to provide low-quality non-salient attributes."); Katz, *supra* note 46, at 520; George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q. J. ECON. 488, 494 (1970).

89. Florencia Marotta-Wurgler, *What's in a Standard Form Contract? An Empirical Analysis of Software License Agreements*, 4 J. EMPIRICAL LEGAL STUD. 677, 679–80 (2007).

are not compliant with the associated regulatory guidelines;[90] and that insurance policies often contain pro-seller terms.[91]

A market with only seller-friendly contracts could make both consumers and sellers worse off compared to a situation in which contractual variation could be communicated to consumers and paid for. But it is also possible that overwhelmingly seller-friendly terms *benefit* sellers collectively while hurting consumers as a group.[92] In the absence of competition on terms, the market may converge on a monopolistic equilibrium, or at least one that is not perfectly competitive.[93] If pricing is also less than perfectly competitive, then the benefits that favorable terms provide to sellers will not be fully translated into lower prices for consumers, thereby generating inefficient deadweight loss.[94]

a. There May Not be an Informed Minority That Can Protect Others

Some have argued that the widespread prevalence of seller-friendly terms amid non-readership by *most* consumers may not be a severe problem if at least *some* consumers read contracts and negotiate for better terms on behalf of *all* consumers (i.e., if an "informed minority" exists).[95] However, empirical evidence suggests that such an informed minority does not exist in many consumer markets.[96]

A related argument contends that even if consumers do not read the fine print, a subset of consumers will complain whenever they believe that sellers have treated them unfairly.[97] These "nudniks" may discipline sellers and

90. Florencia Marotta-Wurgler, *Self-Regulation and Competition in Privacy Policies*, 45 J. LEGAL STUD. 513, 515 (2016).

91. Daniel Schwarcz, *Reevaluating Standardized Insurance Policies*, 78 U. CHI. L. REV. 1263, 1315 n.186 (2011).

92. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1207; Oren Bar-Gill & Rebecca Stone, *Pricing Misperceptions: Explaining Pricing Structure in the Cell Phone Service Market*, 9 J. EMPIRICAL LEGAL STUD. 430, 453 (2012); Simkovic, *supra* note 87, at 3–4.

93. Jeffrey M. Perloff & Steven C. Salop, *Equilibrium with Product Differentiation*, 52 REV. ECON. STUD. 107, 115–16 (1985).

94. *See* sources cited *supra* note 87; Korobkin, *Bounded Rationality*, *supra* note 86, at 1211–12. Note that even in perfectly competitive markets, competition might fail to drive prices sufficiently downward because consumers might fail to adequately perceive or understand the value of the terms. For example, sellers can exploit consumer mistakes by offering terms whose benefits consumers tend to over-estimate or that consumers are generally unable to estimate correctly. *E.g.*, BAR-GILL, *supra* note 86, at 13–16.

95. 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 generally* Richard A. Epstein, *Behavioral Economics: Human Errors and Market Corrections*, 73 U. CHI. L. REV. 111 (2006) (suggesting that in a functioning market, competition crowds out consumers' irrational behavior, because knowledgeable consumers are likely to inform their friends about existing market practices).

96. Bakos et al., *supra* note 42, at 3.

97. Yonathan A. Arbel & Roy Shapira, *Theory of the Nudnik: The Future of Consumer Activism and What We Can Do to Stop It*, 73 VAND. L. REV. 929, 931 (2020) [hereinafter Arbel & Shapira,

encourage them to treat *all* consumers fairly, especially given the potential for nudniks to damage sellers' reputations.[98] However, sellers can often differentiate between nudniks and less assertive consumers by providing more favorable treatment only to the subset of consumers who complain.[99] Seller reputation may also be a less effective disciplining mechanism than assumed, for reasons we discuss below in Section II.D.1.b.

b. One-Sided Terms are Likely Efficient Only in Specific, Narrow Contexts

One argument in defense of one-sided, pro-seller terms is that these terms do not harm consumers because sellers rarely enforce them. Sellers will only enforce these terms to prevent opportunistic consumer behavior.[100] This can also benefit good-faith consumers because preventing consumer misbehavior enables sellers to keep prices lower.[101] Sellers will refrain from enforcing these terms abusively because of their investment in reputation and branding. Abusive enforcement that becomes known to consumers could reduce demand for sellers' products or services.[102]

However, in spite of the reputational constraints on sellers' ability to enforce one-sided terms, problems persist. First, most markets are not perfectly competitive.[103] Thus, the underlying assumptions that reputational

Nudnik]; Yonathan A. Arbel & Roy Shapira, *Consumer Activism: From the Informed Minority to the Crusading Minority*, 69 DEPAUL L. REV. 233, 240–41 (2020) [hereinafter Arbel & Shapira, *Consumer Activism*].

98. Arbel & Shapira, *Nudnik*, *supra* note 97, at 931; Arbel & Shapira, *Consumer Activism*, *supra* note 97, at 240–41.

99. *See, e.g.*, David Gilo & Ariel Porat, *The Hidden Roles of Boilerplate and Standard-Form Contracts: Strategic Imposition of Transaction Costs, Segmentation of Consumers, and Anticompetitive Effects*, 104 MICH. L. REV. 983, 1002–03 (2006); Arbel & Shapira, *Nudnik*, *supra* note 97, at 965–66; Meirav Furth-Matzkin, *The Distributive Impacts of Nudnik-Based Activism*, 74 VAND. L. REV. EN BANC 469, 481–83 (2021) [hereinafter Furth-Matzkin, *Nudnik-Based Activism*]; Meirav Furth-Matzkin, *Selective Enforcement of Consumer Contracts: Evidence from the Retail Market* 24–31 (Feb. 20, 2020) (unpublished manuscript) (on file with authors) [hereinafter Furth-Matzkin, *Selective Enforcement*] (finding that sellers are significantly more likely to accept non-receipted returns despite a formal receipt requirement when consumers insist and complain).

100. *See, e.g.*, Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 MICH. L. REV. 827,829–30 (2006); Clayton P. Gillette, *Rolling Contracts as an Agency Problem*, 2004 WIS. L. REV. 679, 706 (2004); Jason Scott Johnston, *The Return of Bargain: An Economic Theory of How Standard-Form Contracts Enable Cooperative Negotiation Between Businesses and Consumers*, 104 MICH. L. REV. 857, 886–91 (2006); Shmuel I. Becher & Tal Z. Zarsky, *Minding the Gap*, 51 CONN. L. REV. 69, 97–98 (2019); and DOUGLAS G. BAIRD, RECONSTRUCTING CONTRACTS 123 (2013).

101. *See* sources cited *supra* note 100.

102. *Id.*

103. *See* JOAN ROBINSON, THE ECONOMICS OF IMPERFECT COMPETITION, at v–vi (2d ed. 1969); ALAN MANNING, MONOPSONY IN MOTION: IMPERFECT COMPETITION IN LABOR MARKETS 11–12 (2003). Korobkin, *Bounded Rationality*, *supra* note 86, at 1212. *See generally* Lee Anne Fennell & Richard H. McAdams, *Inversion Aversion*, 86 U. CHI. L. REV. 797, 797–816 (2019) (arguing that theories that depend on unrealistic assumptions should be "inverted" and taken as evidence that

harm deters sellers from strictly enforcing their contracts and that savings would be passed on to consumers do not necessarily hold.[104] Relatedly, firms can control how reputational information is disseminated and consumed.[105] For example, firms can silence consumers before they voice their complaints, by treating them preferentially or by drowning out their voices in an ocean of positive reviews.[106] Firms can also purchase positive fake reviews and screen out negative reviews or push them down in search engine results.[107] Additionally, firms that advertise in (or own) media outlets are less likely to receive negative coverage from those outlets.[108] Finally, some companies have a business model that entails building a reputation around quality and reducing quality after customer loyalty is firmly established.[109]

Second, reputational concerns may also constrain consumers from engaging in opportunistic behavior, obviating the need for a one-sided contract to protect sellers. This is because sellers can avoid transacting with troublesome consumers.[110] In the era of big data, sellers have more information about consumers than ever before, which they also share with each other.[111] This enables sellers to screen consumers more effectively and may deter consumers from behavior that might restrict their options.

Third, it is highly unlikely that sellers will waive enforcement in certain contexts. For example, sellers are unlikely to deviate from contractual terms that shield them from legal liability or judicial scrutiny, such as arbitration clauses and liability limitations provisions.[112] Indeed, enforcing binding

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different conclusions may hold under more realistic assumptions). The inversion approach can be applied to the standard assumption of perfect market competition.

104. *See, e.g.*, Simkovic, *supra* note 87, at 22; Yuval Procaccia & Alon Harel, *On the Optimal Regulation of Unread Contracts*, 8 REV. L. & ECON. 59, 74 (2012).

105. *See, e.g.*, Arbel & Shapira, *Consumer Activism*, *supra* note 97, at 242–43; Becher & Zarsky, *supra* note 97, at 85–87; ZAMIR & TEICHMAN, *supra* note 35, at 306–07.

106. *See, e.g.*, Arbel & Shapira, *Consumer Activism*, *supra* note 97, at 242–43.

107. *Id.*; Justin Malbon, *Taking Fake Online Consumer Reviews Seriously*, 36 J. CONSUMER POL'Y 139, 146–47 (2013).

108. Umit G. Gurun & Alexander W. Butler, *Don't Believe the Hype: Local Media Slant, Local Advertising, and Firm Value*, 67 J. FIN. 561, 562–64 (2012); Jonathan Reuter & Eric Zitzewitz, *Do Ads Influence Editors? Advertising and Bias in the Financial Media*, 121 Q.J. ECON. 197, 225 (2006); Martin Gilens & Craig Hertzman, *Corporate Ownership and News Bias: Newspaper Coverage of the 1996 Telecommunications Act*, 62 J. POL. 369, 380 (2000).

109. *See, e.g.*, Johnston, *supra* note 100, at 877–80; Jonathan Macey, *The Demise of the Reputational Model in Capital Markets: The Problem of the "Last Period Parasites"*, 60 SYRACUSE L. REV. 427, 430 (2010)

110. *See, e.g.*, Arbel & Shapira, *Nudnik*, *supra* note 97, at 960.

111. *See* sources cited *supra* note 91; *see also* Bin Yu & Munindar P. Singh, *A Social Mechanism of Reputation Management in Electronic Communities*, *in* COOPERATIVE INFORMATION AGENTS IV —THE FUTURE OF INFORMATION AGENTS IN CYBERSPACE 154 (Matthias Klusch & Larry Kerschberg eds., 2000).

112. *See, e.g.*, Furth-Matzkin, *Selective Enforcement*, *supra* note 99, at 7–8; Sarath Sanga, *A New Strategy for Regulating Arbitration*, 113 NW. U. L. REV. 1121, 1152 (2019); Judith Resnik, *Diffusing*

arbitration reduces reputational risks to sellers because arbitration proceedings are private.[113]

Finally, harsh terms enable sellers to adjust their leniency as circumstances change. As a result, consumers face substantial uncertainty about sellers' behavior even when consumers are informed about sellers' on-the-ground policies.[114] Indeed, having a legal entitlement is superior to being at the seller's mercy, even if sellers usually choose to behave more leniently than their contract dictates.[115]

2. Legalized Fraud

Widespread non-readership leaves consumers open to exploitation by dishonest businesses. When consumers do not read their contracts, firms can safely lure consumers in with misrepresentations about their products and services, while qualifying or disclaiming these assertions in the unread fine print.[116] As previously noted, firms often use "integration," "merger", or "entire agreement" clauses, providing that the written agreement supersedes any prior communications between the parties.[117]

Recognizing that many consumers would refrain from transacting if they had to read the contract, companies often employ sales personnel to help consumers understand the material aspects of the transaction.[118]

The fact that firms choose to disclaim representations made by their salespeople, even written representations that carry few evidentiary issues, suggests that firms do not trust their agents to always accurately represent the terms of the deal.[119] A number of investigations by state Attorneys General and other regulators have uncovered evidence, such as sales training materials, indicating that companies encourage their salespeople to exaggerate the benefits of their products to increase sales.[120] In addition,

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Disputes: The Public in the Private of Arbitration, the Private in Courts, and the Erasure of Rights, 124 YALE L.J. 2804, 2870–72 (2015).

113. *See, e.g.*, Talia Fisher, *Law and Economics of Alternative Dispute Resolution*, *in* THE OXFORD HANDBOOK OF LAW AND ECONOMICS 283 (Francesco Parisi ed., 2017); Judith Resnik, Stephanie Garlock, and Annie J. Wang, *Collective Preclusion and Inaccessible Arbitration: Data, Non-Disclosure, And Public Knowledge,* 24 LEWIS & CLARK L. REV. 611, 624 (2020).

114. *See, e.g.*, Furth-Matzkin, *Selective Enforcement*, *supra* note 99, at 41.

115. *See id.* at 44; Eyal Zamir, *Contract Law and Theory: Three Views of the Cathedral*, 81 U. CHI. L. REV. 2077, 2100 (2014); ZAMIR & TEICHMAN, *supra* note 35, at 311–12.

116. *See, e.g.*, Meirav Furth-Matzkin & Roseanna Sommers, *Consumer Psychology and the Problem of Fine-Print Fraud*, 72 STAN. L. REV. 503, 512 (2020); Korobkin, *The Borat Problem*, *supra* note 75, at 51; Samuel Becher, Yuval Feldman & Meirav Furth, *Toxic Promises*, 63 B.C. L. REV. (forthcoming 2022) (manuscript at 3–5), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3766089 [https://perma.cc/G4ZZ-UCEU].

117. *See supra* Section I.

118. *See* Katz, *supra* note 46, at 521.

119. Davis, *supra* note 75, at 508–511.

120. KEITH B. ANDERSON, FED. TRADE COMM'N, CONSUMER FRAUD IN THE UNITED STATES, 2011: THE THIRD FTC SURVEY, at i–vi, 4–16 (2013), https://www.ftc.gov/sites/default/files/

salespeople are sometimes provided with high-powered incentives and commissions that might push them to defraud consumers.[121]

Sellers know that consumers will likely rely on their agents' representations.[122] While consumers may understand that sellers' representatives sometimes exaggerate or even lie about a specific aspect of the transaction,[123] consumers have to rely on representatives' assertions because they may neither read the contract nor identify other reliable sources of information.[124] Online reviews can be fake,[125] and acquiring information from friends and family is not always feasible.[126] Consumers can obtain information from consumer publications,[127] but most of these publications are dependent on sponsorship from sellers and may provide biased reviews.[128] Consumers typically only procure the services of independent experts in the context of high-stakes transactions such as real-estate contracts.[129] In all other transactions, consumers rely on relatively limited knowledge and on representations made by salespeople.[130]

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documents/reports/consumer-fraud-united-states-2011-third-ftc-survey/130419fraudsurvey_0.pdf [https://perma.cc/D35C-SX58].

121. Becher et al., *supra* note 116, at 46; Abhijit Patwardhan, Stephanie M. Noble, & Ceri M. Nishihara, *The Use of Strategic Deception in Relationships*, 23 J. SERVICES MKT. 318, 319–25 (2009); Debra Pogrund Stark & Jessica M Choplin, *A License To Deceive: Enforcing Contractual Myths Despite Consumer Psychological Realities*, 5 N.Y.U. J.L. & BUS. 617, 651; Liz Ryan, *My Boss Wants Me To Lie To Our Customers*, FORBES (Nov. 29, 2016, 2:56 PM), https://www.forbes.com/sites/lizryan/2016/11/29/my-boss-wants-me-to-lie-to-our-customers [https://perma.cc/EMB2-WHJP]; *In re First All. Mortg. Co.*, 471 F.3d 979, 985 (2006) ("[L]oan officers would … persuade borrowers" to take out overpriced loans. "[T]he elaborate . . . sales presentation prescribed by the manual was unquestionably designed to obfuscate points, fees, interest rate, and the true principal amount of the loan.").

122. *See* Barnes, *supra* note 79, at 260.

123. *See, e.g.*, David A. Hoffman, *The Best Puffery Article Ever*, 91 IOWA L. REV. 1395, 1433–34 (2006).

124. Becher et al., *supra* note 116, at 6.

125. Yonathan A. Arbel, *Reputation Failure: The Limits of Market Discipline in Consumer Markets*, 54 WAKE FOREST L. REV. 1239, 1261 (2019). *See generally* Malbon, *supra* note 107 (discussing the prevalence of fake online reviews).

126. Meirav Furth-Matzkin, *On the Unexpected Use of Unenforceable Contract Terms: Evidence from the Residential Rental Market*, 9 J. LEGAL ANALYSIS 1, 39 (2017) (finding that less than one third of tenants reach out to friends or family to discuss rental problems).

127. *See* Ainsworth Anthony Bailey, *Consumer Awareness and Use of Product Review Websites*, 6 J. INTERACTIVE ADVERT. 68, 76 (2005).

128. Reuter & Zitzewitz, *supra* note 108, at 215; Gurun & Butler, *supra* note 108, at 565–66; Fabrizio Germano & Martin Meier, *Concentration and Self-Censorship in Commercial Media*, 97 J. PUB. ECON. 117, 118 (2013); Diego Rinallo & Suman Basuroy, *Does Advertising Spending Influence Media Coverage of the Advertiser?*, 73 J. MKTG. 33, 34 (2009).

129. BAR-GILL, *supra* note 86, at 29; Steven D. Levitt & Chad Syverson, *Market Distortions When Agents Are Better Informed: The Value of Information in Real Estate Transactions*, 90 REV. ECON. & STAT. 599, 599 (2008).

130. Becher et al., *supra* note 116, at 6.

In contrast to the high costs faced by consumers in verifying claims made by sellers' agents, it is generally relatively easy for sellers to train, monitor, and incentivize their own agents to minimize misrepresentations to consumers.[131]

When consumers believe that they have been defrauded, they may sue sellers under state anti-fraud statutes ("UDAP laws").[132] However, even in cases of outright fraud, the "duty to read" may defeat consumers' claims.[133] Courts often interpret UDAP laws as requiring consumers to show "reasonable" reliance to recover for fraud, and refuse to void contracts that disclaim the sellers' oral representations if the plaintiff-consumer had an opportunity to review the terms prior to signing.[134]

Yet when consumers do not read contracts, they also do not read provisions within contracts informing them that the only thing they can rely on is the contract itself.[135] This is true regardless of font size, location, or format of the disclaimer. Consumers fail to read or comprehend these clauses even when they are presented in bold font and "all-caps."[136] This suggests that companies insert "no reliance" or "merger" clauses not in order to alert consumers that they should verify their salespeople's representations, but rather to insulate themselves from liability.

131. Lamar Pierce, Daniel Snow & Andrew McAfee, *Cleaning House: The Impact of Information Technology Monitoring on Employee Theft and Productivity*, 61 MGMT. SCI. 2299, 2316–17 (2015); Laura Evans, *Monitoring Technology in the American Workplace: Would Adopting English Privacy Standards Better Balance Employee Privacy and Productivity?*, 95 CALIF. L. REV. 1115, 1118–19 (2007); Davis, *supra* note 75, at 510 n.86 (citing John C. Coffee Jr. *"No Soul to Damn: No Body to Kick": An Unscandalized Inquiry into the Problem of Corporate Punishment*, 79 MICH. L. REV. 386 (1981)); Reinier H. Kraakman, *Corporate Liability Strategies and the Costs of Legal Controls*, 93 YALE L.J. 857, 859–60 (1984); Alan O. Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231, 1236–38 (1984).

132. *See generally* NATIONAL CONSUMER LAW CENTER INC., A 50-STATE REPORT ON UNFAIR AND DECEPTIVE ACTS AND PRACTICES STATUTES (2009), https://www.nclc.org/images/pdf/udap/report_50_states.pdf [https://perma.cc/R9TG-PW9A] (discussing state consumer protection laws).

133. Stark & Choplin, *supra* note 121, at 623–24.

134. *See, e.g.*, *id.*, at 623; Victor E. Schwartz & Cary Silverman, *Common-Sense Construction of Consumer Protection Acts*, 54 U. KAN. L. REV. 1, 70 (2005); Alon Klement, Zvika Neeman & Yuval Procaccia, *Consumer Fraud, Misrepresentation and Reliance*, 54 INT'L REV. L. & ECON. 95, 97–98 (2018); Becher et al., *supra* note 116, at 4; *see also* Torres v. State Farm Fire & Cas. Co., 438 So.2d 757, 758–59 (Ala. 1983) ("Because it is the policy of courts not only to discourage fraud but also to discourage negligence . . . the right of reliance comes with a concomitant duty on the part of the plaintiffs to exercise some measure of precaution to safeguard their interests.").

135. *See* Barnes, *supra* note 79, at 260.

136. Yonathan A. Arbel & Andrew Toler, *ALL-CAPS*, 17 J. EMPIRICAL LEGAL STUD. 862, 865 (2020).

3. Sellers as Undemocratic Legislatures

The duty to read as applied by the courts has empowered firms to supersede judicially and legislatively enacted entitlements with firm-imposed provisions, or "private legislation."[137]

Firm-drafted consumer contracts often "delete rights that are granted through democratic processes, substituting for them the system that the firm wishes to impose."[138] Margaret J. Radin has labeled this problem "democratic degradation," observing that consumers "must enter a legal universe of the firm's devising in order to engage in transactions with the firm."[139]

Policymakers often seek to protect consumers from exploitative and deceptive market practices by imposing default rules that apply when the contract is otherwise silent.[140] However, defaults barely constrain firms' private law-making power.[141] Opt-out costs to firms are fixed given that they often use boilerplates drafted by lawyers or commercial associations. Yet, the benefits from opt-outs grow with sales volume. When defaults are costly to sellers,[142] sellers' benefits from opting out can exceed the associated costs.[143]

In response to this problem, states sometimes adopt mandatory rules granting consumers rights and remedies that cannot be disclaimed or qualified under a contract.[144] Yet, even when the law gives consumers non-waivable substantive rights, firms can prevent consumers from enforcing them.

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137. *See* KATHARINA PISTOR, THE CODE OF CAPITAL: HOW THE LAW CREATES WEALTH & INEQUALITY 146–47 (2014); Macaulay, *supra* note 57, at 1095 n.107; MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW 97–99 (2013).

138. RADIN, *supra* note 137, at 16.

139. *Id.* at 16–17.

140. *See generally* Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989) (discussing the difference between default rules and "immutable" rules); Ariel Porat & Lior Jacob Strahilevitz, *Personalizing Default Rules and Disclosure with Big Data*, 112 MICH. L. REV. 1417 (2014) (discussing personalized default rules in contracts that are specific to an individual's personality and past behaviors.).

141. *See* Margaret Jane Radin, *Boilerplate Today: The Rise of Modularity and the Waning of Consent*, 104 MICH. L. REV. 1223, 1224, 1227–28 (2006) [hereinafter Radin, *Boilerplate Today*].

142. Note, however, that defaults are often favorable to sellers because of their active participation in the legislative process.

143. *See generally* Willis, *supra* note 20 (discussing the fact that default clauses may not be sticky in part because the party that benefits the most of these clauses may opt out in specific circumstances).

144. *See generally* Eyal Zamir & Ian Ayres, *A Theory of Mandatory Rules: Typology, Policy, and Design*, 99 TEX. L. REV. 283 (2020) (arguing that the failure of disclosure duties may point toward a need for more regulation of contract clause); Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983) (considering various economic and moral justifications for paternalism in contract law).

First, firms can ignore consumer-protective legislation by including in their agreements terms they know to be unenforceable and void.[145] The fact that contractual terms could be legally unenforceable dramatically increases the readership costs to consumers, because, to fully understand the contract, consumers would need to conduct extensive research about the governing legal framework.[146] If firms only included enforceable terms, readership costs would be lower and the expected benefits from reading would be significantly higher.

Second, the inclusion of unenforceable terms may lead consumers to make mistakes because they might assume that these terms are enforceable.[147] Although many consumers may not read the contract, either in part or in whole, before agreeing to its terms,[148] they may read it when a problem materializes. At that point in time, they might be misled by the inclusion of unenforceable clauses, and either underestimate or unwittingly waive their mandatory rights and remedies.[149] Indeed, many consumers will be deterred from hiring a lawyer or taking legal action because of the chilling effect of the unenforceable provisions. Survey and experimental evidence from residential leases reveals that such mistakes are pervasive.[150] Most consumers do not read the contract before signing, are surprised by its terms when a problem materializes, and are misled by unenforceable terms into surrendering their formally non-waivable rights.[151]

Third, while the cost to consumers can be high, the costs to firms of including a contemporaneously unenforceable provision are generally negligible.[152] Firms typically include "savings" or "severability" clauses in their contracts. providing that if a part of the contract is invalidated, the rest of the contract remains in effect. Such clauses are often included in addition to legal fallback language, stipulating that a certain provision applies "to the

145. Dennis P. Stolle & Andrew J. Slain, *Standard Form Contracts and Contracts Schemas: A Preliminary Investigation of the Effects of Exculpatory Clauses on Consumers' Propensity to Sue*, 15 BEHAV. SCIS. & L. 83, 85 (1997); Furth-Matzkin, *supra* note 126, at 10; Wilkinson-Ryan, *supra* note 49, at 148; Richard R. W. Brooks, *Covenants Without Courts: Enforcing Residential Segregation with Legally Unenforceable Agreements*, 101 AM. ECON. REV. 360, 360 (2011).

146. Meirav Furth-Matzkin, *The Harmful Effects of Unenforceable Contract Terms: Experimental Evidence*, 70 ALA. L. REV. 1031, 1035 (2019).

147. *Id.*

148. Bakos et al., *supra* note 42, at 1–2; BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 7.

149. Furth-Matzkin, *supra* note 126, at 2; Furth-Matzkin, *supra* note 146, at 1058.

150. Furth-Matzkin, *supra* note 126, at 2; Furth-Matzkin, *supra* note 146, at 1058.

151. Furth-Matzkin, *supra* note 126, at 2; Furth-Matzkin, *supra* note 146, at 1058.

152. Furth-Matzkin, *supra* note 126, at 2; Furth-Matzkin, *supra* note 146, at 1058; Wilkinson-Ryan, *supra* note 49, at 123–38.

maximum extent allowed by law" or "unless otherwise prohibited by law."[153] Thus, firms are not deterred from overreaching.[154]

Fourth, only a few jurisdictions penalize drafters for intentionally including unenforceable terms in their contracts, and violations are rarely enforced.[155] It is difficult to prove intent in these cases, as firms may include such terms for ostensibly benign reasons, including a desire to protect against changes in the law, hope that the law might change, legal ambiguity, or a "low-cost" response to cross-jurisdiction variation.[156] Widespread seller non-compliance indicates that such behavior is still profitable to firms, probably because probability of detection or sanctions are insufficient.[157]

Fifth, binding arbitration clauses can prevent consumers from enforcing non-waivable rights by precluding them from litigating their claims collectively.[158] Consequently, consumers might be discouraged from arbitrating at all, particularly when their claims are only significant in the aggregate.

Finally, policymakers often complement substantive regulation with disclosure obligations.[159] In particular, sellers may be required to disclose the law or make deviations from default rules conspicuous.[160] Yet, there is evidence that such disclosures do not, in fact, increase readership or comprehension, and may even decrease them by overwhelming consumers.[161] Nevertheless, such disclosures can immunize contracts from judicial scrutiny by strengthening the presumption of consumer consent.[162]

In sum, firms unilaterally make the rules. Defaults, disclosures, and perhaps even mandatory substantive rules, only weakly constrain firms' rule-

153. Furth-Matzkin, *supra* note 126, at 6.

154. Even in the absence of these clauses, courts may enforce the remainder of the contract. *See, e.g.*, Zamir & Ayres, *supra* note 144, at 337–38.

155. *Id.*

156. *See* Furth-Matzkin, *supra* note 126, at 1.

157. Without evidence about whether the current level of enforcement is socially optimal, no inference can be made about the social desirability of the underlying laws. *See, e.g.*, Furth-Matzkin, *supra* note 126, at 45.

158. Cynthia Estlund, *The Black Hole of Mandatory Arbitration*, 96 N.C. L. REV. 679, 703 (2018); Troy A. McKenzie, *"Helpless" Groups*, 81 FORDHAM L. REV. 3213, 3214 (2013).

159. BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 37.

160. *See, e.g.*, MICHAEL S. BARR, SENDHIL MULLAINATHAN & ELDAR SHAFIR, BEHAVIORALLY INFORMED FINANCIAL SERVICES REGULATION 8 (2008) ("propos[ing] that a default be established with increased liability . . . for deviations that harm consumers" and noting "[d]eviation[s] . . . would require heightened disclosures . . . to make the default 'sticky'").

161. BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 44–45 (surveying empirical evidence about the effects of disclosures on consumers' understanding and decisions, concluding that "[e]ven in ideal circumstances, informed-consent disclosures fail").

162. *See, e.g.*, BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 59–60; Furth-Matkzin & Sommers, *supra* note 116, at 543.

making power. Indeed, standardized contracts often enable firms to change the terms of the deal retroactively, sometimes without even notifying consumers.[163]

4. Increased Inequality

So far, we have discussed problems that emerge from consumers' non-readership of contracts while treating consumers as homogenous. Realistically, consumers are heterogeneous with respect to reading and comprehension abilities, sophistication, and negotiating skills.[164] This generates distributional concerns—not only about wealth transfer from consumers to sellers, but also from lower income, less educated customers to higher income, more educated customers.[165]

Higher income consumers typically have higher education levels, fewer stressors and distractions, and greater ability to concentrate and process information.[166] Conversely, illiterate and non-English-speaking consumers may struggle with contracts.[167] Therefore, unreadable contracts may disproportionately disadvantage lower income, less educated consumers,[168] and attention overload through contractual complexity may contribute to rising inequality.[169]

On one view, associated with economic analysis of law, wealth distribution is best dealt with through taxes and transfers, while legal rules should be

163. Oren Bar-Gill & Kevin Davis, *Empty Promises*, 84 S. CAL. L. REV. 1, 9–10 (2010).

164. *See, e.g.*, RADIN, *supra* note 137, at 257–58, 260–62.

165. On the relationship between contracts and social and economic inequality, see generally Talia B. Gillis & Jann L. Spiess, *Big Data and Discrimination*, 86 U. CHI. L. REV. 459 (2019) (discussing discrimination in consumer credit markets); Manisha Padi, *Contractual Inequality*, Mich. L. Rev. (forthcoming 2022) (on discriminatory enforcement of mortgage servicers' right to foreclose).

166. *See generally* MULLAINATHAN & SHAFIR, *supra* note 7 (describing scarcity in everyday life; Anandi Mani, Sendhil Mullainathan, Eldar Safir & Jiaying Zhao, *Poverty Impedes Cognitive Function*, 341 SCI. 976 (2013) (suggesting that the impoverished expend more of their cognitive capacity on preoccupations, reducing their ability to fully address other problems); Anuj K. Shah, Sendhil Mullainathan & Eldar Shafir, *Some Consequences of Having Too Little*, 338 SCI. 682 (2012) ("The poor often behave in ways that reinforce poverty."); Charles Murray, *IQ and Income Inequality in a Sample of Sibling Pairs from Advantaged Family Backgrounds*, 92 AM. ECON. REV. 339 (2002) (analyzing the IQ of sibling pairs with "virtually no illegitimacy, divorce, [or] poverty").

167. White & Mansfield, *supra* note 48, at 234.

168. *See generally* David Gilo & Ariel Porat, *The Hidden Roles of Boilerplate and Standard-Form Contracts: Strategic Imposition of Transaction Costs, Segmentation of Consumers, and Anticompetitive Effects*, 104 MICH. L. REV. 983 (2006) (stating the purpose of boilerplate provisions and standard form contracts is to create information asymmetry); Kathleen C. Engel & Patricia A. McCoy, *A Tale of Three Markets: The Law and Economics of Predatory Lending*, 80 TEX. L. REV. 1255 (2002) (proposing a duty of suitability to address predatory lending).

169. *See, e.g.*, Stark & Choplin, *supra* note 121, at 696–70 (finding that better educated and higher income consumers were more likely to read the contract than lower educated, poorer consumers).

evaluated based on efficiency.[170] Nevertheless, the extent to which legal rules contribute to wealth disparities may shape public perceptions of the fairness and legitimacy of both those rules and that distribution.[171] Moreover, at least some jurisdictions are beginning to adjust contract law to try to curb inequality.[172]

III. A NEW SOLUTION: PROPORTIONAL CONTRACTS

As described above, consumers typically do not read or understand contracts, and it generally does not make sense for them to do so. In a world in which consumers do not pay attention to contracts, there will not be robust competition between sellers over terms.[173] Consumers' non-readership gives sellers free reign to include pro-seller terms.[174] These terms will not redound to consumers' benefit as long as cost savings to sellers are not fully passed through to consumers in the form of lower price or higher product quality.[175] This is often the case, as many markets are less than perfectly competitive.[176] Thus, unread pro-seller terms allow sellers to earn supra-competitive profits at consumers' expense.[177]

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170. Louis Kaplow & Steven Shavell, *Fairness Versus Welfare*, 114 HARV. L. REV. 961, 993–94 (2001); LOUIS KAPLOW & STEVEN SHAVELL, FAIRNESS VERSUS WELFARE 460 (First Harv. Univ. Press paperback ed. 2006). For opposing or more nuanced views, see generally Zachary Liscow, *Reducing Inequality on the Cheap: When Legal Rule Design Should Incorporate Equity as Well as Efficiency*, 123 YALE L.J. 2478 (2014) (analyzing how in some instances, distributing income according to legal rules is more efficient than distributing through taxation); Lee Anne Fennell & Richard H. McAdams, *The Distributive Deficit in Law and Economics*, 100 MINN. L. REV. 1051 (2016) (bringing attention to inefficiencies in distributions intended to maximize welfare); Alex Raskolnikov, *Distributional Arguments in Reverse*, 105 MINN. L. REV. 1583 (2021) ("[T]he government should consider . . . distributional consequences both in the design of legal rules and during legal transitions."); Brian Galle, *Is Local Consumer Protection Law a Better Redistributive Mechanism than the Tax System?*, 65 N.Y.U. ANN. SURV. AM. L. 525 (2010) (suggesting that local tort law "may be more efficient than local or national redistributive taxation"); Jens Dammann, *Contractual Symmetry: A Doctrinal & Economic Analysis*, 97 DENV. L. REV. 449 (2020) (showing, using game theory, that requiring contractual symmetry typically does not promote efficiency); Daphna Lewinsohn-Zamir, *In Defense of Redistribution Through Private Law*, 91 MINN. L. REV. 326 (2006) (arguing that in certain contexts, it is more efficient to redistribute through private law rules than through taxation).

171. For a similar view, see, for example, Lewinsohn-Zamir, *supra* note 170, at 358–65.

172. Kevin E. Davis & Mariana Pargendler, *Contract Law & Inequality*, 107 IOWA L. REV. (forthcoming 2022) (N.Y.U. L. & Econ. Rsch. Paper, Paper No. 21-11, 2021) (manuscript at 22–40), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3860204 [https://perma.cc/W42J-UBGG].

173. *See supra* note 16 and accompanying text.

174. *See supra* notes 87–89 and accompanying text.

175. *See supra* notes 85–86 and accompanying text.

176. *Id.*

177. *Id.*

Consumer attempts to read a few of these contracts can exhaust their limited attention and prevent them from reading other contracts.[178] Thus, consumer contracts—by their very existence—create negative externalities, depleting consumer attention from other contracts.

Currently, sellers do not need consumers to read or understand contracts to bind consumers to their terms. Sellers therefore have no incentive to conserve consumer attention by making their contracts leaner. As a result, contracts get longer while consumers' stock of attention remains constant, and sellers can include more and more pro-seller terms with less and less consumer scrutiny of each term.[179]

In effect, by imposing a universal duty to read, regulators and courts treat consumers' time and attention as if they were unlimited when they are in fact scarce.[180] In other contexts, regulators recognize that decision-makers' time and attention are scarce. Procedural rules that impose length limitations on briefs and motions conserve judges' limited time and attention.[181] Similarly, scholars have recently called for regulators to reduce administrative "sludge," or excessive burden, by reducing paperwork requirements and using shorter forms.[182]

Consistent with these efforts, we propose that sellers be forced to internalize the attention costs they impose on consumers through lengthy and complex contracts.

A critical framework for our proposal is that consumer attention is a scarce resource.[183] Regulation should therefore channel markets to conserve this resource. Toward that end, we propose that sellers pay a Pigouvian tax each time they present a contract to consumers.[184] The tax will depend on the

178. Sellers may educate consumers about certain terms which may then become salient to consumers, such as extended warranties. However, the number of terms that can be salient to consumers is limited because of consumers' bounded attention. *See, e.g.*, Korobkin, *Bounded Rationality, supra* note 86, at 1206, 1254–55, 1272; BAR-GILL, *supra* note 86, at 13–16.

179. *See* HENDRICKS & VESTERGAARD, *supra* note 10, at 3–4.

180. *See, e.g.*, HAROLD E. PASHLER, THE PSYCHOLOGY OF ATTENTION 2–3 (1999); Josef Falkinger, *Limited Attention as a Scarce Resource in Information–Rich Economies*, 118 ECON. J. 1596, 1596 (2008).

181. *See, e.g.*, FED. R. APP. P. 32(a)(7).

182. *See, e.g.*, Richard H. Thaler, *Nudge, Not Sludge*, 361 SCI. 431, 431 (2018); Cass R. Sunstein, *Sludge and Ordeals*, 68 DUKE L.J. 1843, 1873–83 (2019); Cass R. Sunstein, *Sludge Audits* 3–4, (Harv. Pub. L. Working Paper No. 19–21, 2019) (forthcoming, BEHAV. PUB. POL'Y) (manuscript at 3–4), https://www.cambridge.org/core/journals/behavioural-public-policy/article/sludge-audits/12A7E338984CE8807CC1E078EC4F13A7/share/01e7996cfbf6967527889ab65040499d2e778d7c [https://perma.cc/9FVU-A8K9].

183. *See supra* notes 1–21 and accompanying text.

184. For a definition of Pigouvian taxation, see *supra* note 27 and *infra* note 192.

amount of consumer and lawyer time required for a representative consumer to adequately understand the contract.[185]

Our approach addresses systemic problems with the length and complexity of contracts that lead to consumer cognitive overload. With this tax, sellers will incorporate the costs to consumers of reading and understanding the terms into their contract drafting decisions. We predict that this will encourage sellers to draft shorter, simpler contracts. Contractual complexity and length will fall from their current levels, which maximize sellers' profits, to levels that maximize social welfare.

As explained below, we propose that any aspects of the parties' relationship not otherwise covered by the contract will be governed by default rules promulgated through a political process. While defaults rules are not a new idea,[186] making opt outs costlier will increase the use of defaults, thereby leading private parties and public officials to dedicate more resources to improving default rules.

This framework implies that more private ordering is not always better.[187] Instead, there is an optimum which depends on the limits of consumer attention. The benefits of private ordering decline as consumer attention is depleted. Sellers' over-use of consumer attention breaks the market for terms. Consumers cease paying attention and sellers draft unilateral contracts that do not incorporate consumer preferences.[188] When sellers use an appropriate level of consumer attention, consumers will be more likely to read and understand contracts. As contract terms become more salient to consumers, sellers will have incentives to compete by improving terms.[189]

A. CONSERVING CONSUMER ATTENTION

Sellers often use standardized contracts across consumers entering the same transaction. Because of this contractual uniformity, consumers who do not read the contract benefit from those who do because readers can push sellers to offer better terms. A competitive market for terms depends on consumers' collective attention, which is a scarce common resource.[190] Complicated contracts deplete this resource, generating negative externalities.

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185. We use the monetary cost of time as a proxy for attention because time is easier to quantify. *See generally* DAVENPORT & BECK, *supra* note 6 (discussing the importance of gaining consumer's attention for long-term business growth).

186. Note that this is already the case in many areas of contract law that are governed by state statutory law. Notable examples include the Uniform Commercial Code (as adopted by the state) which primarily consists of default rules and only a very limited number of mandatory rules.

187. Markus & Schwartz, *supra* note 22, at 351–52; SCHWARTZ, *supra* note 4, at 3; SHEENA IYENGAR, THE ART OF CHOOSING 9 (2011).

188. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1206.

189. *Id.* at 1234 (suggesting that as terms become salient, sellers compete over them).

190. *See* Paul A. Samuelson, *Diagrammatic Exposition of a Theory of Public Expenditure*, 37 REV. ECON. & STAT. 350, 351–53 (1955) (defining a common resource as scarce and non-excludable).

If too few consumers pay attention, other consumers are harmed. The lack of consumer participation reduces competition and leads to worse terms. Since reading one contract draws attention away from others, complex contracts not only deflect scrutiny from their own terms, but also from the terms of other contracts.

There are three main methods of limiting negative externalities generated by over-exploitation of common resources.[191] The first is a Pigouvian tax roughly in proportion to the negative externality that the use of the resource generates.[192] The second is cap-and-trade, whereby total use is capped at a level regulators deem efficient and rights to use are subsequently traded. The third is command-and-control, whereby the regulator prohibits or limits the use of the resource in particular contexts.[193]

In the context of consumer contracts, a cap-and-trade system would be difficult to administer. This is because regulators would need to decide the optimal amount of time that consumers should spend reading contracts. Command-and-control is similarly difficult to administer.[194] To promulgate optimal command-and-control rules, regulators must determine both the costs and benefits of longer, more detailed contracts, which can be difficult to quantify.[195]

In contrast, Pigouvian taxation demands less information and expertise from the regulator.[196] All that is required is that regulators estimate the social cost of the externality-generating activity or proxy it with the cost of mitigating the harm.[197] Because policymakers have limited information about the benefits and costs of contractual customization and the optimal levels of use of consumer attention,[198] a Pigouvian tax is superior to cap-and-trade or

191. *See, e.g.*, Michael J. Graetz, THE END OF ENERGY: THE UNMAKING OF AMERICA'S ENVIRONMENT, SECURITY, AND INDEPENDENCE 198–216 (MIT Press 2011).

192. PIGOU, *supra* note 27, at 195–96; A. Mitchell Polinsky & Steven Shavell, *Pigouvian Taxation with Administrative Costs*, 19 J. PUB. ECON. 385, 385–86 (1982); Gilbert E. Metcalf, *Environmental Levies and Distortionary Taxation: Pigou, Taxation and Pollution*, 87 J. PUB. ECON. 313, 313–14 (2003).

193. *See generally* Darren Sinclair, *Self-Regulation Versus Command and Control? Beyond False Dichotomies*, 19 L. & POL'Y 529, 534 (1997) (explaining command-and-control as when governments "*command[]* industr[ies] to meet specific . . . standards . . . and *control[]* [their] behavior through . . . negative sanctions").

194. *Id.* at 535. S*ee generally* Dan Awrey & Kathryn Judge, *Why Financial Regulation Keeps Falling Short*, 61 B.C. L. REV. 2295 (2020) (discussing the information challenges facing regulators).

195. *See, e.g.*, Radin, *Boilerplate Today*, *supra* note 141, at 1224 (discussing difficultly of quantifying costs and benefits of contract customization).

196. *See* Masur & Posner, *supra* note 28, at 138.

197. *Id.* at 101, 138.

198. *Id.* at 102; Louis Kaplow & Steven Shavell, *On the Superiority of Corrective Taxes to Quantity Regulation*, 4 AM. L. & ECON. REV. 1, 3–4 (2002); David Weisbach, *Instrument Choice Is Instrument Design in* U.S. ENERGY TAX POLICY 122–23 (Gilbert E. Metcalf ed., 2011); CASS R. SUNSTEIN, RISK AND REASON: SAFETY, LAW, AND THE ENVIRONMENT 270 (2004).

command-and-control regulation.[199] We therefore focus our analysis on Pigouvian taxation.

B. PIGOUVIAN TAXATION OF ATTENTION EXTERNALITIES FROM CONSUMER CONTRACTS

Pigouvian taxation will force sellers to internalize attention costs that they currently impose on consumers. Taxing consumer contracts based on sellers' use of consumers' attention ensures that sellers will use contracts to deviate from defaults only when the benefit to sellers exceeds the costs to consumers in time and attention.[200]

Sellers' contracts may impose costs on consumers beyond the costs of reading. For example, sellers may include excessively pro-seller terms, sometimes without fully adjusting prices.[201] Although our proposal does not directly limit sellers' choice of terms, we expect it to ameliorate the attendant problem of rents through second-order effects. As contracts get shorter and simpler across the economy, consumers will be able to pay more attention to each contract. Consumers will then understand more of the contractual terms they encounter. The resulting increased competition will restrict the use of pro-seller terms.

1. Putting a Price on Consumer Attention

Below, we propose a method that regulators could use to estimate the cost to a "representative consumer" of reading a contract. By "representative," we mean either the average or another point in the distribution of the subpopulation of consumers entering the specific contract. Regulators can use the attention costs to the representative consumer to set the tax per contract presentation.

As a proxy for attention, we suggest using the monetary cost of time.[202] Consumers attempting to understand a contract can generally choose either of two approaches. They can read the contract without assistance or hire a

199. Outside the context of consumer contracts, Pigouvian taxation has long been preferred over command-and-control or cap-and-trade regulation by many economists. *See, e.g.*, Steven Shavell, *Corrective Taxation Versus Liability as a Solution to the Problem of Harmful Externalities*, 54 J.L. & ECON. S249, S249 (2011) ("The corrective tax has long been viewed by most economists as . . . the . . . theoretically preferred remedy for the problem of harmful externalities."); N. Gregory Mankiw, *Smart Taxes: An Open Invitation to Join the Pigou Club*, 35 E. ECON. J. 14, 15 (2009); Masur & Posner, *supra* note 28, at 95; Weisbach, *supra* note 198, at 119–21.

200. *See, e.g.*, Sunstein, *Sludge Audits*, supra note 182, at 3; Masur & Posner, *supra* note 28, at 100. If deviations benefit *consumers* in ways that sellers cannot capture through pricing, sellers might under-customize contracts. However, it is unlikely that sellers will be unable to capture the benefits of terms that help consumers. This is because sellers should be able to market improved terms to consumers (i.e., "free returns") while adjusting prices upward or expanding sales volume.

201. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1211–12.

202. *See generally supra* note 31 and accompanying text; *supra* note 185 and accompanying text.

lawyer to read and explain the contract to them.[203] Rational consumers would choose the least expensive approach that yields sufficient comprehension.[204]

Regulators would therefore need to determine the cost of direct versus assisted readership, and whether either produces sufficient comprehension levels. Cost and comprehension could be estimated by testing representative consumer samples. Consumers would be randomly assigned to one of two balanced groups. Half would be assisted by lawyers, and half would read on their own.

These consumers would then be surveyed about their comprehension of the terms and their legal implications.[205] Regulators would need to set a minimum understanding threshold and a minimum fraction of consumers that must exceed that threshold (for example, 90 percent comprehension of the contract by 80 percent of consumers). The percent of consumers required to understand the contract would depend on assessments of the critical mass of informed consumers required to make markets for terms sufficiently competitive.

The costs associated with hiring a lawyer would include both the average cost of the lawyers' time across consumers and the average opportunity costs of the consumers' time.[206] The costs of reading contracts without assistance would be the opportunity costs of consumers' time.[207] Consumers' opportunity costs should be measured on the margin because these costs increase as free time decreases. Marginal opportunity costs could be estimated based on consumers' hourly earnings increased by a multiplier, similar to

203. Although consumers may obtain a free explanation from sellers' agents, such an explanation might be oversimplified or more biased than an explanation from independent legal experts.

204. Some have argued that advances in artificial intelligence may make contracts easier to understand, providing guidance similar to lawyers. *See* Yonathan A. Arbel & Shmuel I. Becher, *Contracts in the Age of Smart Readers*, 90 GEO. WASH. L. REV. (forthcoming 2021) (Univ. Ala. L. Stud. Rsch. Paper, Paper No. 3740356, 2021) (manuscript at 26), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3740356 [https://perma.cc/JS63-RPHW]; Rory Van Loo, *Digital Market Perfection*, 117 MICH. L. REV. 815, 835–36 (2019). However, there will still be an associated cost with using such technology, and neutrality could be an issue if the seller is the one providing access to that technology. *See* Andrew D. Selbst, *Negligence and AI's Human Users*, 100 B.U. L. REV. 1315, 1351 (2020).

205. For proposals to survey consumers in similar contexts, *see, e.g.*, Ayres & Schwartz, *supra* note 41, at 606; Omri Ben-Shahar & Lior Jacob Strahilevitz, *Interpreting Contracts via Surveys and Experiments*, 92 N.Y.U. L. REV. 1753, 1766 (2017); Lauren E. Willis, *Performance-Based Remedies: Ordering Firms to Eradicate Their Own Fraud*, 80 L. & CONTEMP. PROBS. 7, 25 (2017).

206. For consumers who hire a lawyer, costs would include the time required to locate and hire the lawyer and to comprehend the contract.

207. It is unclear whether this should include all consumers or only the subset who actually understand the contract. The latter approach may be sufficient to estimate the cost of creating a critical mass of consumers to police contractual efficiency.

overtime pay calculations.[208] Although marginal pricing does not measure consumers' disutility from reading contracts, it may serve as a second-best approximation.

This method would be used to establish a per-customer Pigouvian tax based on the least expensive reading option in which consumer comprehension exceeds the minimum thresholds. Sellers would pay this tax *every* time they present the contract to a consumer, regardless of whether the consumer signs the contract,[209] because attention costs are imposed even when consumers ultimately choose not to transact.

2. Comprehensive Cost-Benefit Analysis May Not Be Feasible

The approach above calls on regulators to estimate only what it would cost consumers to read and understand a contract. It *does not* require regulators to estimate whether it would make sense for consumers to read, given the costs and benefits of doing so. Such analysis would be difficult to administer. It would turn not only on the attention costs of reading, but also on the likely benefits from reading, or the costs of failing to do so.

The benefits of reading depend on multiple factors, including the value of the contract to the consumer, the materiality of the terms, and the consumer's bargaining power (i.e., the consumer's ability to either negotiate the terms or shop for a better deal). Quantifying these factors could be challenging given the complexities involved in measuring them.[210]

Regulators could potentially use proxies to approximate some expected benefits. For example, they could use the sum of money associated with the transaction as a proxy for the value of the transaction to the consumer; or market concentration ratios as proxies for market competition and consumers' respective bargaining power.[211] However, these proxies are crude and partial, and might yield high measurement errors.

Thus, an approach that includes estimated benefits of reading to consumers may not be more precise than one that only includes estimated attention costs. Moreover, estimating both the costs and benefits of contract readership would undoubtedly impose higher administrative costs, compared

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208. ROBERT A. HART, THE ECONOMICS OF OVERTIME WORKING 86 (2004) (noting that overtime work is typically compensated at 50 percent above regular wages to compensate workers for the disutility of working longer hours).

209. To avoid paying the fee, sellers may delay presenting the contract until they are confident that a sale is likely. However, in many contexts, sellers already delay presenting the contract until late in the process to increase the chances of a sale (for example, by creating a sense of "sunk cost" for consumers). Thus, our proposal is not likely to significantly change sellers' practices.

210. Estimating whether contract terms are material requires knowing their subjective value, as well as the probability that each will be triggered. Regulators may struggle to discover both.

211. For a survey of various proxies used to measure market competition, see Florencia Marotta-Wurgler, *Competition and the Quality of Standard Form Contracts: The Case of Software License Agreements*, 5 J. EMPIRICAL LEGAL STUD. 447, 463 (2008).

to an approach that only estimates readership costs. Therefore, even if a full cost-benefit analysis were more precise, the increase in precision may not justify the increase in administrative burden. As explained in detail below, taxation may suffice to encourage roughly efficient levels of contract complexity and length.

Ideally, Pigouvian taxation should be calibrated to reflect the social harm of the taxed activity. In practice, however, this is often not possible. For example, in the environmental context, polluters are often charged the cost of cleaning up pollution rather than the social harm from pollution.[212] In taxing sellers for attention costs rather than the social costs of discouraging consumers from reading contracts, we follow an analogous approach. Consumers would be encouraged to read both by making contracts shorter and simpler and, if necessary, through payments to readers, as explained below.

3. Pigouvian Taxation May Change Seller Behavior

Taxing sellers will raise their costs of using contracts, thereby leading sellers to reduce the number, length, and complexity of their contracts.[213] Some of these newly imposed costs might be passed on to consumers. However, if markets were not initially competitive, most of these costs could be absorbed by sellers without a price increase. This is because in non-competitive markets, sellers price their products or services according to consumers' willingness to pay, rather than marginal costs. Resulting supra-competitive profits, often referred to as "rents," are typically considered inefficient. Reducing sellers' profit margins may lead them to supply fewer goods. However, Pigouvian taxation may actually facilitate market entry by eroding the advantage that larger sellers have over smaller, less experienced players by virtue of having more complex contracts.[214] Furthermore, consumer attention would be conserved, thereby encouraging comparison shopping and competition.

How might sellers change their contracts in a world with Pigouvian taxation?[215] We expect valuable contractual provisions to survive, while inefficient or overly complex provisions, like an extended warranty for an inexpensive item, are likely to collapse under the weight of the high associated

212. *See, e.g.*, Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. § 9601 (2018).

213. *See* EMMA HUTCHINSON, PRINCIPLES OF MICROECONOMICS 219–24 (2016).

214. *See* Michael Simkovic & Miao Ben Zhang, Regulation and Technology-Driven Entry: Measurement and Micro-Evidence 3–4 (Sept. 14, 2020) (unpublished manuscript), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3205589 [https://perma.cc/7SW5-V6GF].

215. *See, e.g.*, Henry E. Smith, *Complexity and the Cathedral: Making Law and Economics More Calabresian*, 48 EUR. J.L. & ECON. 43, 50–51 (2019) (discussing the evolution of legal systems through feedback loops and interactions).

taxes.[216] For some low-value transactions, sellers might not use a contract at all, as is frequently the case today.[217]

Sellers might also shift toward technological rather than contractual solutions. For example, sellers could make it difficult to use their product or service in a manner that is currently prohibited by contract.[218] This shift from contract toward property protection could achieve sellers' goals while using less consumer attention.

As noted above, some common contractual provisions dramatically increase consumer comprehension costs even though they can be short and easy to read. This is because they have far-reaching legal implications that are difficult for most consumers to understand without legal assistance.[219] Such clauses would include, for example, binding arbitration, merger clauses, liability waivers, warranty disclaimers, unilateral change clauses, cross-collateralization clauses, the inclusion of unenforceable terms and accompanying 'savings' or severability clauses, and choice of law clauses. Because consumers would likely need to hire an attorney to understand these clauses' implications, the tax for including such clauses would be high.[220]

Some of these clauses may be so valuable to sellers that they will nevertheless be included, at least sometimes. Consumers will be more likely to understand the consequences of consenting to such terms because sellers will attempt to make their contracts shorter and simpler.[221] If consumers understand and accept these terms, then their continued inclusion would provide *prima facie* evidence that they are efficient.

Alternatively, if consumers still fail to understand these terms' implications—even with legal assistance and even after sellers have simplified their contracts—then there may be no price at which such terms could be included in contracts. If legally assisted consumers cannot understand these terms, but the terms are nevertheless efficient, then these terms should

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216. Such warranties on inexpensive items are notoriously overpriced. CHRISTIAN TWIGG-FLESNER, CONSUMER PRODUCT GUARANTEES 99 (2016); Korobkin, *Bounded Rationality*, *supra* note 86, at 1209–10; Zhiqi Chen & Thomas W. Ross, *Why Are Extended Warranties So Expensive?*, 45 ECON. LETTERS 253, 253 (1994).

217. For example, restaurants and grocery stores do not typically use contracts when transacting with consumers.

218. For example, technical solutions can make it difficult to copy and paste or scrape text from a website. LAWRENCE LESSIG, CODE AND OTHER LAWS OF CYBERSPACE 57 (1999).

219. Jeff Sovern, Elayne E. Greenberg, Paul F. Kirgis & Yuxiang Liu, *"Whimsy Little Contracts" with Unexpected Consequences: An Empirical Analysis of Consumer Understanding of Arbitration Agreements*, 75 MD. L. REV. 1, 4 (2015) (reporting that less than half of the survey respondents knew whether the contract they had just read included an arbitration clause, and that most of those who did know failed to understand the legal ramification of the provision).

220. See *supra* Section IV.B.1.

221. For example, there is evidence that the introduction of a standardized interest rate, the APR, has made it easier for consumers to understand and comparison-shop for credit. *See* Oren Bar-Gill, *supra* note 86, at 125–26.

become the default.[222] However, if such terms are not efficient, then they should be prohibited. Regardless, when consumer comprehension is not possible, the political process may produce a more efficient result than sellers' unilateral choices.[223]

4. Should Consumers Be Paid to Read Contracts?

Taxing sellers based on the attention costs their contracts impose would likely lead to shorter, simpler contracts. However, it is possible that most consumers will still fail to read. This could be because of a collective action problem: If each consumer hopes that other consumers will read and negotiate the terms, consumers may free-ride on other consumers' efforts. Consequently, there will not be a sufficiently large group of readers to create a competitive market for contractual terms.

This collective action problem could be mitigated by compensating consumers who choose to read the contract and can demonstrate comprehension. Supplementary compensation could be paid to those who post an online review of the contract. Just as sellers pay lawyers to ensure that *someone* reads contracts, this would increase the chances that at least some consumers read. Compensation would reward readers for the positive externalities they generate.

One concern is that compensating consumers for reading could incentivize some consumers with ample free time to read excessively without real intent to transact. Even if the compensation comes from regulators rather than from sellers directly, sellers would pay a tax each time they present a contract to consumers. Thus, compensating consumers for reading would increase the burdens on sellers to distinguish good-faith customers from opportunistic readers.[224] But sellers already have incentives to avoid customers who waste salespeople's time without transacting. In addition, some opportunistic readers, after interacting with sellers, may discover that they wish to transact after all.

If the problem of opportunistic readership proves to be significant, it could be addressed by providing compensation for reading that is relatively low, or providing higher compensation to consumers who read and transact. Thus, readership would be subsidized (because of associated positive externalities) but not fully compensated.

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222. For example, it might not be possible to make certain calculations of pension or insurance payouts or methods of calculating compound interest comprehensible to most consumers.

223. *See, e.g.*, Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 371, 394–95 (1983) (arguing that political processes tend toward efficient rules).

224. Regulators in turn would need to ensure that sellers only turn away opportunistic readers as opposed to good-faith readers. Sellers may wish to screen out good-faith readers to avoid pressure to improve their contracts vis-à-vis all consumers.

5. Enforcement and administration

Imposing a new tax requires authorities to ensure compliance.[225] This is typically accomplished through random auditing and varying penalties for non-compliance. Penalties are typically more severe for willful non-compliance than for innocent mistakes. Penalties are also typically more severe when willful non-compliance is more difficult to detect so that infrequent but severe penalties deter tax evasion.[226]

Detection of non-compliance can be greatly increased through third-party information reporting or systems to reward and protect whistleblowers.[227] For example, third-party reporting by employers of employee wages on W-2 forms and contractor pay on 1099 forms has dramatically reduced underreported income.

Similarly, we propose that sellers should be required to display a symbol on their contracts indicating whether or not they have paid the tax. A database would be available to the public to check which sellers have paid the tax for which kinds of contracts. Members of the public whose non-compliance reports lead to successful enforcement actions could receive a fee similar to a whistleblower reward.[228]

Sellers who forget to pay the tax and do not display the symbol would be quickly detected and reported. Because such omissions by the seller would likely be due to innocent mistakes, and the probability of detection would be high, such sellers could be penalized lightly. Sellers would have to pay taxes that were previously due (with a market rate of interest), in addition to a small penalty to increase deterrence. On the other hand, sellers who fraudulently display the symbol while not paying the tax would be more difficult to detect and would therefore need to be penalized more severely. Larger, more established firms would likely be more compliant than smaller players because of the higher probability of detection.[229] Consumers recognizing this may rely on larger firms to offer better (shorter, simpler) contracts.

To increase the probability of detection, consumers could be authorized to bring class actions against non-compliant sellers.[230] This could supplement

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225. Collection costs are typically reduced by pre-payments, with refunds or adjustments later.

226. Gary S. Becker, *Crime and Punishment: An Economic Approach*, 76 J. POL. ECON. 169, 174 (1968).

227. *See* Joel Slemrod & Shlomo Yitzhaki, *Tax Avoidance, Evasion, and Administration*, *in* 3 HANDBOOK OF PUBLIC ECONOMICS 1423, 1450–54 (Alan J. Auerbach & Martin Feldstein eds., 2002).

228. These rewards are typically structured as a percent of the amount collected. *See* Yehonatan Givati, *A Theory of Whistleblower Rewards*, 45 J. LEGAL STUD. 43, 48–49 (2016).

229. Greater compliance by larger, more established firms may be generally true of regulation and taxation. Wayne B. Gray & Mary E. Deily, *Compliance and Enforcement: Air Pollution Regulation in the U.S. Steel Industry*, 31 J. ENV'T ECON. & MGMT. 96, 99 (1996).

230. *See* John C. Coffee, Jr., *Understanding the Plaintiff's Attorney: The Implications of Economic Theory for Private Enforcement of Law Through Class and Derivative Actions*, 86 COLUM. L. REV. 669, 683 (1986); Bryant Garth, Ilene H. Nagel & S. Jay Plager, *The Institution of the Private Attorney General: Perspectives from an Empirical Study of Class Action Litigation*, 61 S. CAL. L. REV. 353, 379, 383 (1988).

regulatory enforcement measures and keep enforcement levels steadier across political cycles.

6. Pigouvian Taxation Versus Mandatory Substantive Rules

One advantage of our proposed taxation of contractual complexity is its flexibility compared to mandatory rules.[231] Indeed, our proposal can help regulators use an incremental approach to try to make a term comprehensible to consumers before resorting to more aggressive means. Unlike mandates, Pigouvian taxation requires relatively little information and expertise by regulators.[232] Unlike mandates, it preserves room for contractual innovation.[233] And unlike *laissez faire*, our approach sets background market conditions so that those innovations will likely be pro-social.

Our flexible approach may not solve all problems in consumer markets. Pigouvian taxation makes sellers internalize only some costs to consumers and relies on market competition to police others. Where competitive conditions remain elusive, other regulatory interventions—including mandatory restrictions on the inclusion of certain terms—may be needed.[234]

Pigouvian taxation is compatible with contract law regimes with either many mandates or none. When certain contractual terms are prohibited, Pigouvian taxation can still encourage sellers to simplify terms that are permitted.

C. FILLING GAPS IN CONTRACTS

Our proposal will lead to contracts being shorter and simpler. Market competition will channel opt-outs in a pro-social direction. However, shorter contracts will not cover as many aspects of the relationships between sellers and consumers as under the current state-of-affairs. This could be either beneficial or problematic.

Less complete contracts could be beneficial if longer contracts, though more specific, were inefficiently one-sided. Instead of referring to such contracts as a benchmark, the parties may bargain ex post. Agreement may be reached instead based on prevailing business practices, prior practices

231. Of course, with 100 percent mandatory rules, our proposal would become obsolete. Katharina Pistor argues for regulatory opt-outs and participation. Fabrizio Cafaggi & Katharina Pistor, *Regulatory Capabilities: A Normative Framework for Assessing the Distributional Effects of Regulation*, 9 REG. & GOV. 95, 102–03 (2015).

232. *See, e.g.*, Zamir & Ayres, *supra* note 144, at 314 (explaining that mandates require regulatory expertise).

233. *See, e.g.*, Michael S. Barr, Sendhil Mullainathan & Eldar Shafir, *Behaviorally Informed Regulation*, *in* THE BEHAVIORAL FOUNDATIONS OF PUBLIC POLICY 440, 448–49 (Eldar Shafir ed., 2013) (observing that mandatory substantive regulation stifles innovation); Kevin E. Davis, *Contracts as Technology*, 88 N.Y.U. L. REV. 83, 89–91 (2013).

234. *See, e.g.*, Furth-Matzkin, *supra* note 126, at 4; Zamir & Ayres, *supra* note 144, at 325–26; Masur & Posner, *supra* note 28, at 131.

between the parties, or notions of fairness.[235] Bargaining power may still influence the negotiations, but once the inefficient contractual benchmark is removed, it may be easier to reach an efficient outcome.[236]

Note that the costs of *ex post* negotiation might prevent contracting parties from resolving their differences without assistance. In such situations, a gap-filling mechanism may be necessary to resolve disputes. This could either be done through statute or regulation or through the development of common law. While a common law approach may allow for more flexibility statutory default rules would provide more certainty and predictability.

Defaults would likely be created through a political process similar to the process currently used to create uniform state laws or restatements of law. Currently, the American Law Institute and the Uniform Laws Commission draft model laws which can then be adopted in whole or in part by state legislatures.[237] The ALI and ULC create forums for input from representatives of both consumers (or academics who may be sympathetic to their interests) and businesses (i.e., elite lawyers) as well as presumptively neutral legal experts (i.e., judges).[238] Uniform laws can then be adopted in whole or modified by state legislatures. Thus, the process of drafting default rules would combine deliberation, participation, and technical expertise with democratic political legitimacy.[239]

We predict that taxation will lead to shorter contracts, and that this will lead to default rules becoming more important.[240] As a result, sellers' and consumers' representatives would have greater incentives to participate in the

235. *See, e.g.*, David Frydlinger & Oliver D. Hart, *Overcoming Contractual Incompleteness: The Role of Guiding Principles* 35–40 (Sept. 2020) (unpublished manuscript), https://scholar.harvard.edu/hart/publications/overcoming-contractual-incompleteness-role-guiding-principals [https://perma.cc/76PX-K29A].; Robert C. Ellickson, *The Market for Social Norms*, 3 AM. L. & ECON. REV. 1, 43 (2001); Robert C. Ellickson, *Of Coase and Cattle: Dispute Resolution Among Neighbors in Shasta County*, 38 STAN. L. REV. 623, 672–75 (1986).

236. Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 664 (1998).

237. G. Edward White, *The American Law Institute and the Triumph of Modernist Jurisprudence*, 15 L. & HIST. REV. 1, 11 (1997).

238. Jonathan R. Macey, *The Transformation of the American Law Institute*, 61 GEO. WASH. L. REV. 1212, 1231–32 (1993).

239. *See generally* Jonathan R. Macey, *Packaged Preferences and the Institutional Transformation of Interests*, 61 U. CHI. L. REV. 1443 (1994) (arguing that mediating institutions are better decision makers than individuals); Stephanie M. Stern, *Outpsyched: The Battle of Expertise in Psychology-Informed Law*, 57 JURIMETRICS J.L., SCI. & TECH. 45 (2016) (arguing that business and interest groups are better than government officials at deploying psychological insights); Nicholas R. Parrillo, *Should the Public Get To Participate Before Federal Agencies Issue Guidance? An Empirical Study*, 71 ADMIN. L. REV. 57 (2019) (arguing that the optimal amount of public participation varies by context).

240. *See generally* Ryan Bubb & Richard H. Pildes, *How Behavioral Economics Trims Its Sails and Why*, 127 HARV. L. REV. 1593 (2014) (arguing that default rules often end of functioning as de-facto mandates).

political process that crafts these defaults.[241] Such increased participation would likely improve the quality of default rules.

We expect consumer contracts, consisting of both explicit terms and incorporated default rules, to become more efficient and less biased in favor of sellers over time. Admittedly, some groups with stronger political power (typically sellers) may have a stronger influence on how default rules are shaped.[242] Yet, political processes still generally produce efficient policies because welfare gains can be shared among interest groups to reduce opposition.[243] This system of salient contract terms supplemented by legislative defaults will replace the current system, in which virtually all terms are unilaterally drafted by sellers without any formal representation of consumers. Even skeptics must acknowledge that there are clear examples of consumer-protective compromises in commercial law which were crafted through ALI and ULC processes.[244]

Returning to our previous example of binding arbitration provisions in consumer contracts, sellers typically argue that arbitration is efficient, increases speed, protects the privacy of both parties, and reduces costs of resolving disputes.[245] By contrast, consumer advocates argue that arbitration enables sellers to exert greater control over the process as repeat players, select pro-seller arbitrators, and eliminate class action lawsuits, thereby depriving most consumers of redress given the small size of their individual claims.[246] Under the current system, sellers routinely include binding arbitration provisions, and these are routinely enforced. A default rule drafted as a political compromise through a deliberative process might provide as follows:

Arbitration

> Disputes shall be submitted to binding arbitration, with the arbitrator mutually agreed by both seller and either (1) a member organization of the Consumer Federation of America ("CFA")

241. James Gibson, *Boilerplate's False Dichotomy*, 106 GEO. L.J. 249, 269–74 (2018).

242. *See, e.g.*, Becker, *supra* note 223, at 385–86.

243. *Id.* at 388–96.

244. One example of a consumer-protective rule created through the ALI and ULC processes relate to the procedures secured creditors must follow to retain collateral, rather than sell it, in the event of non-payment by a debtor. Policymakers worry that creditors will understate the value of collateral and pursue debtors for excessive deficiencies. To prevent this, a creditor must either: (1) sell the collateral; or (2) reach a written agreement with the borrower establishing the value of the collateral and the deficiency, if any. However, in the case of consumers, if the debtor has already paid 60 percent of the balance of the loan, a creditor can *only* pursue a deficiency after a sale. U.C.C. §§ 9-620(e), 9-610 (AM. L. INST. & UNIF. L. COMM'N 2010). There is no option for a consumer to agree to a deficiency without a sale of the collateral.

245. Resnik, *supra note* 112, at 2918; Robert C. Ellickson, *When Civil Society Uses an Iron Fist: The Roles of Private Associations in Rulemaking and Adjudication*, 18 AM. L. & ECON. REV. 235, 249–52 (2016).

246. *See* Resnik, *supra* note 112, at 2887–93; Ellickson, *supra* note 245, at 242–44.

> selected by the CFA or (2) by buyer directly, if buyer prefers. Arbitration proceedings must make aggregated group arbitration proceedings available to buyers with substantially similar claims if buyers opt into group representation.

This compromise language offers the presumptive efficiencies and privacy of arbitration to sellers, without the problems of one-sidedness or cutting off the possibility of a class action or mass tort proceeding. Thus, it could be politically agreeable to both sellers and buyers.

Sellers could still opt for a more traditional arbitration provision, but this could be made costly because of the increased tax on the contract, reflecting the increased cost to consumers of understanding the legal consequences of such provisions.

Scholars have extensively debated how defaults should ideally be designed.[247] According to one line of thought, default rules should be punitive toward drafting parties to force them to opt out of the default and thereby convey information to non-drafting parties. This approach is not consistent with our proposal, which aims to encourage sellers to minimize the extent to which they deplete consumers' attention. Instead, defaults should reflect what the parties would have agreed to on their own if they were well-informed and had the resources to negotiate.[248] This could be modified to compensate for bargaining and information asymmetries. In fact, the process of crafting default rules *provides* a forum for consumers and sellers to negotiate collectively while allowing for context-specific rules for different types of transactions.

There are tradeoffs between context-specificity and administrability.[249] The more context-specific the default rules, the greater the cost up front of crafting multiple sets of defaults.[250] *Ex post* costs could also be higher if parties litigate over which set of defaults apply. Finally, having multiple sets of default rules for different contexts would make it more difficult for consumers to learn which rules apply. Nevertheless, the costs to consumers of learning would likely be smaller than the costs of reading each private contract.

In addition, if individual consumers do not pay attention to default rules, the potential harm to them will likely be smaller because of upfront consumer representation in the drafting process. Thus, one-time costs of collective

247. *See, e.g.*, Ayres & Gertner, *supra* note 140, at 91; Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1591–94 (1999).

248. Yair Listokin, *The Meaning of Contractual Silence: A Field Experiment*, 2 J. LEGAL ANALYSIS 397, 406–10 (2010) (finding evidence that consumers correctly interpret contractual silence as reflecting majoritarian default rules).

249. Oren Bar-Gill & Clayton P. Gillette, *On the Optimal Number of Contract Types*, 20 THEORETICAL INQUIRIES L. 487, 490-92 (2019).

250. *See, e.g.*, Ian Ayres & Robert Gertner, *Strategic Contractual Inefficiency and the Optimal Choice of Legal Rules*, 101 YALE L.J. 729, 733 (1992).

representation amortized across consumers would replace repeated reading and negotiation costs imposed individually on each consumer.

D. COSTS AND BENEFITS

A possible critique of our proposal is that it could raise transaction costs by imposing a tax. But our proposal may actually reduce the costs of contracting. This is because sellers can forego the costs of developing varied contracts and instead use default rules.[251] As noted above in Section III.C, default rules can be drafted through a political process that incorporates input from both sellers and consumers. Because this is a collective mechanism, sellers may collectively save on attorneys' fees and avoid *over-production* of varied terms that are functionally similar.

Just as form contracts reduce costs to sellers by standardizing terms across transactions,[252] default rules that are widely used across sellers reduce costs by standardizing terms across an even broader group of transactions.[253] As consumers become familiar with more uniform terms,[254] they will be able to focus their attention on other attributes of goods or services. Consequently, market competition on these other attributes will increase. Standardization may also facilitate competition by reducing the advantage that larger producers currently enjoy thanks to proportionately lower fixed costs of contracting.

To the extent that variation in contracts is valuable, for example, because consumers have heterogenous preferences, sellers can still offer a menu of contracts by opting out of the defaults.[255] This preserves freedom of contract; sellers need only internalize the attention externalities that they generate.

Increased standardization under our proposal is likely to be closer to optimal than under the status quo. This is because the optimal level of standardization versus customization cannot be inferred from market practice in the presence of attention externalities.[256]

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251. *See, e.g.*, Radin, *Boilerplate Today*, *supra* note 141, at 1224.

252. *See, e.g.*, HENRY N. BUTLER, CHRISTOPHER R. DRAHOZAL & JOANNA M. SHEPHERD, ECONOMIC ANALYSIS FOR LAWYERS 183 (3d ed. 2014); Barnett, *supra* note 66, at 630–31 (explaining that standard forms benefit sellers and consumers by facilitating transactions); Robert A. Hillman, *Rolling Contracts*, 71 FORDHAM L. REV. 743, 747 (2002) ("By using the form [contract] for each transaction, sellers standardize risks and reduce bargaining costs."); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 115 (6th ed. 2003) (explaining that sellers prefer form contracts to individual negotiations because they reduce both transaction costs and agency costs).

253. *See, e.g.*, Radin, *Boilerplate Today*, *supra* note 141, at 1224; Richard Berner & Kathryn Judge, *The Data Standardization Challenge*, in SYSTEMIC RISK IN THE FINANCIAL SECTOR: TEN YEARS AFTER THE GREAT CRASH 135–36 (Douglas W. Arner, Emilios Avgouleas, Danny Busch and Steven L. Schwarcz ed., 2019).

254. *See, e.g.*, Ayres & Schwartz, *supra* note 41 at 587–89.

255. *See, e.g.*, Zamir & Ayres, *supra* note 144, at 319–20.

256. From the perspective of sophisticated businesses, the proliferation of complex, highly varied contractual terms across consumer markets can be profit-maximizing to the firm—but not

Business-to-business markets suffer from fewer of these problems and may therefore offer some insights. In the context of business-to-business contracts, standardization often emerges to promote greater efficiency while facilitating limited opportunities for customization.[257] For example, derivative contracts incorporate a standardized ISDA master agreement which is modified principally through schedules specifying only economically salient terms. An industry trade association maintains and updates the master agreement and the definitions used to interpret it.[258]

Similarly, in real estate sales and lease agreements, standard form agreements are generated by commercial providers, such as realtors' associations, to facilitate a high volume of transactions without imposing excessive information costs on either party.[259]

Thus, when both contracting parties have sufficient economic incentives to read and become informed, we often see voluntary adoption of increased standardization. Excessive customization can contribute to widespread uncertainty as multiple versions of the same term proliferate. Case law clarifying the meaning of one version of these terms can cast doubt on the meaning of all other variations.[260] Standardization thereby increases the efficiency of case law in clarifying the meaning of terms.

But can default rules be sensitive to context? We believe that the answer is yes. Even in the context of mandates—which are often thought to reflexively favor "one-size-fits-all" solutions—there is considerably more context-specificity than has traditionally been assumed.[261] For example, the Card Act of 2009 explicitly bans certain methods of calculating interest payments in credit card contracts.[262] However, this ban does not apply to other types of credit products, like commercial revolving credit facilities or mortgages.[263]

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necessarily socially efficient—because higher search costs that overwhelm consumers reduce competition and facilitate oligopolistic pricing.

257. Robert K. Rasmussen & Michael Simkovic, *Bounties for Errors: Market Testing Contracts*, 10 HARV. BUS. L. REV. 117, 119–20 (2020).

258. *Id.* at 124–27.

259. Furth-Matzkin, *supra* note 126, at 10–11.

260. Rasmussen & Simkovic, *supra* note 257, at 136–40; Stephen J. Choi, Mitu Gulati & Robert E. Scott, *Variation in Boilerplate: Rational Design or Random Mutation?*, 20 AM. L. & ECON. REV. 1, 1–7 (2017).

261. *See* Zamir & Ayres, *supra* note 144, at 298–300.

262. Michael Simkovic, *Credit Card Reform and Bankruptcy Reform*, 10 NORTON BANKR. L. ADVISER 1, 1 (2009).

263. Simkovic, *supra* note 87 at 9; BAR-GILL, *supra* note 86, at 118–19; Susan Block-Lieb & Edward J. Janger, *The Myth of the Rational Borrower: Rationality, Behavioralism, and the Misguided "Reform" of Bankruptcy Law*, 84 TEX. L. REV. 1481, 1515 (2006); CAROLYN B. MOLONEY & CHARLES E. SCHUMER, VICIOUS CYCLE: HOW UNFAIR CREDIT CARD PRACTICES ARE SQUEEZING CONSUMERS AND UNDERMINING THE RECOVERY 3, 5 (1st Sess. 2009). This difference is based on policymakers' assumptions, supported by empirical evidence, that consumers using credit cards typically do not understand some complex pricing terms and that this opacity leads to a less competitive market in which rents accrue to credit card lenders.

Default rules can also vary by context. For example, if two investors form a non-Delaware partnership without specifying how much each owns, they each own half by default.[264] However, if two investors form a Delaware limited liability company or a corporation without specifying ownership, then by default, governance rights are shared in proportion to their capital contributions.[265]

One concern with Proportional Contracts is that greater reliance on default rules may place higher burdens on consumers to become informed of the default rules. Although default rules may be simpler and more standardized than form contracts, some research may still be required to learn these rules. This research can be facilitated by third parties such as non-profits or government agencies, which can provide simple comprehensible summaries of default rules, as many now do for tenants' rights, air passengers rights, and other issues.[266] Sellers may also provide links to relevant default rules. Such links could be exempt from taxation. While some consumers may only learn about default rules *ex post* after an issue arises, consumers will likely become familiar with default rules over time because the rules would be standardized and would likely change slowly. Consumers will therefore be more attuned to deviations from those rules. Once consumers become informed about the default rules, this knowledge can be used across multiple transactions with different sellers. Note, however, that even consumers who are not aware of default rules would typically benefit from our proposal because the contracts they enter into are likely to be more consumer friendly than contracts unilaterally drafted by sellers.

E. DISTRIBUTIONAL CONSEQUENCES

Proportional contracts may have distributional consequences between: (1) sellers and consumers; and (2) among sellers. We anticipate that our proposed solution would generate egalitarian consequences, favoring consumers over sellers and smaller sellers over larger sellers.[267]

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264. UNIF. P'SHIP ACT § 401, 4 U.L.A. 95–101 (2013).

265. DEL. CODE ANN. tit. 6, § 18-402 (West 1999).

266. For example, the U.S. Department of Housing and Urban Development, and many local governments, post information online about tenants' rights. The Department of Transportation posts information about air passengers' rights. The CFPB posts information online about consumer finance contracts (e.g., credit cards, loans). *See, e.g.*, *Tenant Rights, Laws and Protections: California*, U.S. DEP'T HOUS. & URB. DEV., https://www.hud.gov/states/california/renting/tenantrights [https://perma.cc/MK3D-WP8S]; *Fly Rights*, U.S. DEP'T TRANSP. (Oct. 4, 2019), https://www.transportation.gov/airconsumer/fly-rights [https://perma.cc/2A7N-HLVN]; *Consumer Resources*, U.S. CONSUMER FIN. PROT. BUREAU, https://www.consumerfinance.gov/consumer-tools [https://perma.cc/PVJ6-BC7T]. Many attorneys also post information online to help attract potential clients.

267. Among consumers at different income levels, the distributional consequences of Proportional Contracts are ambiguous. For example, it is not clear whether taxes would be higher or lower on sellers presenting the same contract to lower income consumers versus higher income consumers. On the one hand, lower-income consumers (who are typically less educated)

1. Consumers Versus Sellers

Our proposal would likely favor consumers over sellers to the extent that sellers cannot pass through the full costs of new taxes and shorter contracts to consumers through higher prices. If there is payment to readers, the proposal would favor consumers even more.

In aggregate, considering differences in income or wealth across groups, favoring consumers is generally egalitarian. This is because business ownership is concentrated toward the top of the wealth distribution.[268] By contrast, consumption is less concentrated at the top.[269]

A shift toward default rules would also likely favor consumers compared to the status quo of unilaterally drafted contracts.[270]

2. Large Versus Small Sellers

Among sellers, our proposal would likely favor smaller sellers over larger, more sophisticated sellers. There are several reasons for this. First, larger companies will be taxed more heavily because they have a larger customer base. In addition, as contracts shrink and more sellers use default rules, larger and smaller sellers' contracts will become more similar. If the economies of scale and sophistication of larger sellers previously enabled them to draft contracts more favorable to themselves (compared to smaller sellers), a shift toward using more default rules and greater standardization will likewise favor smaller sellers.[271]

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may take longer to read and understand contracts or require the assistance of an attorney to get above the comprehension threshold. On the other hand, high-income consumers typically have higher hourly earnings and therefore a higher opportunity cost of reading. Nor is it clear whether sellers would be able to pass through additional costs to consumers or segment consumers by offering different contracts for consumers at different income levels.

268. *Release Tables: Shares of Wealth by Wealth Percentile Groups*, FED. RSRV. ECON. DATA, https://fred.stlouisfed.org/release/tables?rid=453&eid=813804#snid=813876 [https://perma.cc/32TV-LW3L].

269. Christopher D. Carroll, *Why Do the Rich Save so Much?*, *in* DOES ATLAS SHRUG? THE ECONOMIC CONSEQUENCES OF TAXING THE RICH 465, 476–78 (Joel B. Slemrod ed., 2000).

270. We recognize, however, that the promulgated defaults might still be skewed toward sellers because of sellers' superior political organization and influence. *See, e.g.*, Becker, *supra* note 223, at 371–76; George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3, 10–17 (1971).

271. On the other hand, if reputational constraints generally restrain larger, repeat sellers from overly one-sided contracts, standardization may favor these larger sellers relative to more aggressive small sellers because both types of sellers will converge on less seller-friendly terms. *See, e.g.*, Jens Frankenreiter, *The Missing "California Effect" in Data Privacy* 53 (Wash. Univ. St. Louis, Legal Stud. Rsch. Paper No. 21–07–01, 2021), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3883728 [https://perma.cc/B6KM-BMED] (finding that larger technology companies offered higher levels of data privacy to U.S. consumers after the GDPR went into effect compared to smaller firms).

Favoring smaller sellers would likely have egalitarian consequences, as income levels for workers in smaller businesses are typically lower.[272]

As noted above, larger sellers may be more compliant with proposed taxes and regulations.[273] If so, the effect on larger versus smaller sellers would be ambiguous; larger sellers would have to pay more in taxes but may benefit from a reputation for more even-handed contracts. If the proposed regulations increased barriers to entry, this would also likely favor incumbents (typically larger sellers). On the other hand, shifting toward improved default rules may reduce barriers to entry.

F. ADMINISTRATIVE COSTS

Establishing and maintaining a system of Proportional Contracts would entail administrative costs. First, regulators would need to gather and pay survey participants. Second, there would likely be an iterative process as sellers seek to improve their contracts and ask regulators to resurvey consumers to test improved versions. Third, regulators would have to design comprehension tests to use with consumers. Fourth, regulators would need to estimate the financial costs of reading and comprehension at a sufficient level based on relevant consumer hourly earnings and attorneys' fees. Fifth, regulators would need to ensure compliance through audits and enforcement actions. Sixth, as noted above, more resources would be invested by sellers and consumers in drafting default rules. If compensation is offered to consumers to read contracts, this would also entail administrative costs.

Many of these costs will be low *per transaction*. Sellers typically use standard form contracts—either drafted in-house or taken off-the-shelf from a third-party provider—across many consumers. Thanks to these economies of scale, regulators would only need to evaluate a relatively small number of contracts. Because regulators would take advantage of the same economies of scale that sellers currently use when drafting consumer contracts, administrative costs would be low relative to the aggregate value of consumer transactions. Regulators could also minimize administrative costs by pricing based on relatively small but representative groups of test-consumers.

A significant portion of the administrative cost will be incurred initially when the regulator evaluates each contract to set the tax on presentation of this contract to consumers. Back-of-the-envelope calculations suggest that the total initial evaluation costs per contract would likely range between $40,000 to $100,000.[274] Assuming one million consumers per form contract, this

272. Charles Brown & James Medoff, *The Employer Size–Wage Effect*, 97 J. POL. ECON. 1027, 1056 (1989).

273. *See supra* note 229 and accompanying text.

274. This figure was estimated as follows: Assume that a consumer's time reviewing contracts costs on average $40 per hour, including costs of recruiting participants. Also assume that it would require 100 consumers on average two hours each to read and answer questions about a typical contract. This implies an initial evaluation cost of $8,000. Assume that attorney time is

implies that the evaluation costs of each contract would work out to roughly 4 to 10 cents per customer.[275] To put this into context, Blumberg sells New York apartment lease forms for $1.05 per form when buying a package of 48 forms.[276] Legal Zoom sells residential lease forms across states for $29 per lease.[277]

This initial contract evaluation cost would be negligible compared to the value of a typical consumer transaction. Contract evaluation cost would also be small compared to the typical Pigouvian tax imposed to reflect the attention costs to consumers.

Thus, the cost of initially evaluating contracts could either be: (1) funded through user fees charged to sellers; (2) provided free at the point of service and recouped by the government through subsequent taxation of approved contracts; or (3) as an intermediate option.

Under the intermediate option, sellers would be charged user fees which would only cover a portion of the cost to evaluate a contract. The remaining costs would be recouped through subsequent taxation of presentations of contracts to consumers. User fees would force sellers to internalize some of the cost of evaluating their contract. Sellers would thereby be discouraged from excessive use of form contracts or excessive retesting. On the other hand, subsidizing the initial evaluation process would encourage greater use of contracts and contractual innovation.

Another administrative cost is the ongoing cost of enforcement. Regulators' costs of enforcement against sellers to ensure compliance could be minimized through auditing a random subset of sellers every year, third-party reporting, and private plaintiffs.

Finally, administrative costs also include the costs of drafting default rules. As noted above, default drafting costs would be reduced through economies of scale and potentially offset by the benefits of greater standardization.

IV. COMPATIBILITY AND COMPLEMENTARITY WITH EXISTING SOLUTIONS

Courts, state legislatures, and legal scholars have all previously considered a problem closely related to scarce consumer attention: non-

worth $200 per hour and it would require an additional fifty hours of attorney time to read and explain the contract to consumers in the attorney-assisted group. Attorneys' time increases the contract evaluation cost by $10,000 to $18,000. There would be some additional costs for physical space, IT, and regulatory personnel to develop and score comprehension tests and translate this into a tax. In addition, sellers may revise and retest versions of their contract to improve ease of comprehension and reduce the tax.

275. Indeed, evaluating even a small niche form contract used for only 10,000 consumers would likely add at most $10 in cost per consumer.

276. *Blumberg Lease*, BLUMBERG EXCELSIOR, INC., https://www.blumberg.com/invoice.cgi?rm=view_cluster;cluster_id=1762952 [https://perma.cc/TKU7-ML5K].

277. *Residential Lease Pricing*, LEGALZOOM, https://www.legalzoom.com/personal/real-estate/residential-lease-pricing.html [https://perma.cc/VUN9-ECDG].

readership of contracts by consumers.[278] They have arrived at a variety of proposed doctrinal mechanisms for policing these problems. As we explain below, many of these mechanisms are compatible with and complemented by the proportional contracts solution.

A. *UNCONSCIONABILITY DOCTRINE*

The classic solution to the problem of non-readership is for courts to refuse to enforce outrageous terms that "shock the conscience" or, in other words, are "unconscionable".[279] The rationale behind this doctrine is that no consumer could have possibly intended to consent to such terms if the consumer had read them. Unconscionability is therefore evidence of lack of consent.[280]

Our proposed solution is compatible with, and can complement, unconscionability doctrine. Moreover, proportional contracts may reduce the number of situations in which courts feel compelled to apply the doctrine, while simultaneously providing more protection to consumers and greater predictability for sellers.

A helpful illustration of how this could work comes from *Williams v. Walker-Thomas*,[281] a classic case applying the doctrine of unconscionability. In this case, a low-income mother of eight entered a lease-to-own agreement for a stereo set. The agreement included a cross-collateral provision providing that a default on other credit agreements would also constitute a default under the lease-to-own agreement. Enforcement of the clause would have caused the plaintiff to lose her equity in the stereo system after having made multiple payments. The court concluded that the plaintiff did not understand the provision *and* that the provision was unconscionable.

But imagine a world in which the underlying contract was shorter, simpler, and readily comprehensible. Would consumers in the plaintiff's shoes still agree to the contract? Fewer probably would. Thus, consumers could refrain from entering into the one-sided contract *ex ante*, rather than having to sue the seller *ex post*.

If there was evidence that plaintiff understood the clause, but agreed to it anyway, would the courts have still found it to be unconscionable? Some courts might, but this would entail a normative judgement that prioritized egalitarian concerns over freedom of contract. Fewer courts would be willing

278. *See* Bakos et al., *supra* note 42, at 2.

279. *See generally* David Gilo & Ariel Porat, *Viewing Unconscionability Through a Market Lens*, 52 WM. & MARY L. REV. 133 (2010) (discussing doctrine of unconscionability); Korobkin, *Bounded Rationality*, *supra* note 86 (same); Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975) (same); Arthur Allen Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967) (same).

280. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1205.

281. Williams v. Walker-Thomas, 350 F.2d 445, 447 (D.C. Cir. 1965).

to go that far.[282] Thus, by simplifying their contracts, sellers would be able to protect themselves from *ex post* judicial invalidation of contracts.

In addition, default rules would operate as *de facto* safe harbors, because defaults drafted by a legislature, regulatory agency, or persuasive authority like the ALI would be accorded deference from courts. Aggressive application of unconscionability doctrine may lead sellers to hew closely to default rules to protect themselves from unexpected judicial intervention.

Currently, to protect themselves, sellers routinely include severability clauses in their contracts. These clauses mitigate the risk to sellers of including terms that might be deemed unconscionable or otherwise unenforceable because such terms will likely still be enforced to the maximum extent allowed by law.[283]

Under proportional contracts, including severability clauses could be costly for sellers. This is because severability clauses would likely increase the costs to consumers of understanding the contract. Sellers who seek to reduce taxes by forgoing severability clauses will be more reluctant to include terms that might be deemed unconscionable because a court could strike out and effectively rewrite much of the contract.[284]

B. MANDATORY SUBSTANTIVE REGULATION

Consumer non-readership is also addressed through mandatory substantive regulation. Such regulations may prohibit the inclusion of certain terms deemed contrary to public policy, render such terms unenforceable if they are included, or mandate the inclusion of certain terms intended to protect consumers.[285] Such regulation is similar to unconscionability doctrine, but offers greater predictability to sellers because it is promulgated *ex ante* rather than adjudicated *ex post*.

As with unconscionability, substantive regulation is compatible with proportional contracts. Proportional contracts may also make it easier for regulators to promulgate substantive regulation. This is because contracts will be shorter and simpler, and market forces will already deter some provisions that regulators would likely find objectionable. Thus, with shorter, simpler, and less-one sided contracts, it will be easier for regulators to identify the remaining practices that they wish to ban. [286]

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282. *See, e.g.*, George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 J. LEGAL STUD. 65, 72–73 (1977) (arguing that the dynamics of re-litigation and settlement lead to courts tending toward efficient legal rules).

283. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1288.

284. Epstein, *supra* note 279, at 304.

285. *See, e.g.*, Zamir & Ayres, *supra* note 144, at 302–18.

286. Proportional contracts may reduce rather than obviate the need for substantive regulation because a contract that is mutually agreeable to the seller and the buyer might still harm some third party. For example, courts have rendered racially and religiously restrictive covenants in real estate unenforceable to protect minorities. RICHARD R.W. BROOKS & CAROL M.

Note that substantive regulations might be harmful to consumers or to society. For example, regulators may be "captured" by sellers or other interest groups,[287] or regulators may be misinformed or mistaken.[288] In addition, substantive regulations often impose one-size-fits-all requirements.[289] This may reduce social welfare when heterogeneity among consumers or sellers favors more variation in contractual terms.[290] Finally, substantive regulations may impede welfare-enhancing contractual innovations and may be difficult to change.[291]

In contrast to substantive regulation, proportional contracts focuses on process (i.e., giving sellers incentives to shorten and simplify contracts), and then relies on market forces to shape the substance of those contracts. Proportional contracts can act immediately to shorten and simplify contracts before they are used to bind consumers. In contrast, substantive regulation typically responds only to problems that are well-known and well-understood.[292] Regulators often move relatively slowly because of limited resources, inadequate information, and procedural requirements.[293]

Moreover, if proportional contracts and the resulting pushback from buyers moderates seller excesses, there may be less need for substantive

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ROSE, SAVING THE NEIGHBORHOOD: RACIALLY RESTRICTIVE COVENANTS, LAW, AND SOCIAL NORMS 103–05 (2013).

287. *See, e.g.*, Stigler, *supra* note 270, at 3–4; MANCUR OLSON, THE LOGIC OF COLLECTIVE ACTION: PUBLIC GOODS AND THE THEORY OF GROUPS 5–8 (1965). More recent literature argues from both theory and case studies that regulators are often more benign and smaller, weaker interests more successful than the regulatory capture literature traditionally assumes. *See, e.g.*, Becker, *supra* note 223, at 371–73; GUNNAR TRUMBULL, STRENGTH IN NUMBERS: THE POLITICAL POWER OF WEAK INTERESTS 1–3 (2012); STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS: THE POSSIBILITY OF GOOD REGULATORY GOVERNMENT 10–13 (2008).

288. *See, e.g.*, Adam J. Levitin, *The Politics of Financial Regulation and the Regulation of Financial Politics: A Review Essay*, 127 HARV. L. REV. 1991, 2040 (2014).

289. Bubb & Pildes, *supra* note 240, at 1593–1601; Zamir & Ayres, *supra* note 144, at 31; Bar-Gill & Omri Ben-Shahar, *Regulatory Techniques in Consumer Protection: A Critique of European Consumer Contract Law*, 50 COMMON MKT. L. REV. SUPP. 109, 109–11 (2013).

290. *Id.; see also* Katz, *supra* note 46, at 521; *Bounded Rationality*, *supra* note 86, at 1249–52 ("But ex ante mandatory terms cannot be perfectly tailored to the efficiency requirements of context-specific market circumstances . . . ."). *But see* Zamir & Ayres, *supra* note 144, at 318–19 (suggesting that mandatory substantive regulation may also be tailored and is not necessarily "uniform").

291. Eric A. Posner & E. Glen Weyl, *An FDA for Financial Innovation: Applying the Insurable Interest Doctrine to Twenty-First-Century Financial Markets*, 107 NW. U. L. REV. 1307, 1312–13 (2013).

292. Michael Simkovic, *Limited Liability and the Known Unknown*, 68 DUKE L.J. 275, 275–83 (2018); Louis Kaplow, *A Model of the Optimal Complexity of Legal Rules*, 11 J.L. ECON. & ORG. 150, 150–52 (1995).

293. Philip Bond & Vincent Glode, *The Labor Market for Bankers and Regulators*, 27 REV. FIN. STUD. 2539, 2539–43 (2014); Max Schanzenbach, *Explaining the Public-Sector Pay Gap: The Role of Skill and College Major*, 9 J. HUM. CAP. 1, 1–3 (2015); Amy Whritenour Ando, *Waiting to Be Protected under the Endangered Species Act: The Political Economy of Regulatory Delay*, 42 J. L. & ECON. 29, 29–30 (1999).

regulation. This means that simplifying contracts could preserve space for innovation by sellers.

C. ANTI-FRAUD STATUTES (UDAP LAWS)

In most states, anti-fraud statutes provide consumers with seemingly powerful remedies such as voiding contracts when those contracts were entered into as a result of fraud.[294] And there are at least a few cases in which consumers or small businesses successfully voided a contract when they established that a seller orally misrepresented the terms of the deal, and the non-drafting party did not read closely.[295] Relatedly, some courts treat fraud as an exception to the *parol evidence* rule.[296] Several legal scholars support this approach, especially when consumers have been defrauded.[297]

However, in practice, anti-fraud statutes offer less protection than the statutes would suggest. When a conflict arises after a deal has been signed, consumers tend to assume that the contract controls the terms of the deal.[298] As noted above, this perception is enhanced by the routine inclusion in contracts of integration or merger clauses stipulating that the contract supersedes the seller's prior assertions. Thus, consumers will rarely seek legal advice or consider pursuing a claim, believing that they will inevitably lose.[299]

Consumers would therefore be better protected if anti-fraud statutes were complemented by Proportional Contracts. With Proportional Contracts in place, contracts will be shorter and simpler, and differences between the written contract and sellers' assertions will be more noticeable to consumers. Integration clauses would also be more salient. Finally, sellers will be less likely

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294. Korobkin, *Bounded Rationality*, *supra* note 86, at 1255; Stark & Choplin, *supra* note 121, at 622–23; Furth-Matzkin & Sommers, *supra* note 116, at 513–16; Klement et al., *supra* note 134, at 97–98.

295. State v. Vertrue, Inc., 834 N.W.2d 12, 18–19, 21, 34–40 (Iowa 2013); Rowen Petroleum Props., LLC v. Hollywood Tanning Sys., Inc., No. 08–4764, 2009 WL 1085737, at *1–8 (D.N.J. Apr. 20, 2009); Alicia W. Macklin, *The Fraud Exception to the Parol Evidence Rule: Necessary Protection for Fraud Victims or Loophole for Clever Parties*?. 82 S. CAL. L. REV. 809, 810 (2009); Furth-Matzkin & Sommers, *supra* note 116, at 513–15.

296. *E.g.*, Furth-Matzkin & Sommers, *supra* note 116, at 513–15.

297. *See, e.g.*, Eric A. Posner, *The Parol Evidence Rule, the Plain Meaning Rule, and the Principles of Contractual Interpretation*, 146 U. PA. L. REV. 533, 554 (1998) (explaining that "ordinary consumer contracts are good candidates for soft-PER" to allow consumers, but not businesses, to introduce extrinsic evidence); Davis, *supra* note 75, at 531; Gregory Klass, *Parol Evidence Rules and the Mechanics of Choice*, 20 THEORETICAL INQUIRIES L. 457, 463 (2019); IAN AYRES & GREGORY KLASS, INSINCERE PROMISES: THE LAW OF MISREPRESENTED INTENT 153–54 (2008).

298. Furth-Matzkin & Sommers, *supra* note 116, at 516.

299. And indeed, in some cases, courts have upheld the duty to read even in cases of fraudulent oral representations. *See, e.g.*, Korobkin, *The Borat Problem*, *supra* note 75, at 592; Stark & Choplin, *supra* note 121, at 624–25; Furth-Matzkin & Sommers, *supra* note 116, at 527. Without a consumer complaint, public agencies also will typically not initiate an investigation. *See* Katherine Porter, *The Complaint Conundrum: Thoughts on the CFPB's Complaint Mechanism*, 7 BROOK. J. CORP. FIN. & COM. L. 57, 80 (2012); Eric H. Steele, *Fraud, Dispute, and the Consumer: Responding to Consumer Complaints*, 123 U. PA. L. REV. 1107, 1112 (1975).

to include these clauses. Such clauses would likely carry a high cost because it may be difficult for consumers to understand their legal implications without the assistance of an attorney.

D. DISCLOSURES

The most widespread regulatory approach to consumers' failure to read contracts is to require sellers to provide conspicuous notice of key terms to consumers.[300] For example, in consumer finance contracts, lenders are generally required to disclose interest rates in a single, standardized aggregated number, the "Annual Percentage Rate."[301] This is intended to make interest rates easier to compare across contracts even if the interest rates compound differently. In sales of goods contracts, the Magnusson Moss Warranty Act requires that sellers disclose any disclaimers or limitations on warranties.[302] In some contexts, regulators require heightened disclosures or additional consent for deviations from consumer-protective defaults.[303]

States will often pile additional disclosure requirements on top of these federal requirements. For example, in California, sellers and landlords are required to disclose the presence of any chemicals or pollutants that might increase the risk of cancer.[304] Regulated businesses respond by routinely including standard form disclosures to insulate themselves from liability. There is typically only a penalty for failure to disclose, not for excessive, unnecessary, and burdensome disclosures.

Regulators and legislatures have generally piled on more and more disclosures over time, such that the disclosures themselves have become too lengthy and complex for consumers to effectively guide their decision-

300. BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 3; Loewenstein et al., *supra* note 35, at 392.

301. Truth In Lending Act, 15 U.S.C. §§ 1604–1667f (2018); 12 C.F.R. § 226 (2019); Credit Card Act of 2009, Pub. L. No. 111–24, 123 Stat. 1734.

302. *See, e.g.*, Michael J. Wisdom, *An Empirical Study of the Magnuson-Moss Warranty Act*, 31 STAN. L. REV. 1117, 1120 (1979); George Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1306 (1981).

303. *See, e.g.*, MARY GRAHAM, DEMOCRACY BY DISCLOSURE: THE RISE OF TECHNOPOPULISM 64–74 (2002); ARCHON FUNG, MARY GRAHAM & DAVID WEIL, FULL DISCLOSURE: THE PERILS AND PROMISE OF TRANSPARENCY 175–80 (2007); Cass R. Sunstein, *Empirically Informed Regulation*, 78 U. CHI. L. REV. 1349, 1362 (2011); *see also* Ayres & Schwartz, *supra* note 41, at 584; James Gibson, *Vertical Boilerplate*, 70 WASH. & LEE L. REV. 161, 224–27 (2013).

304. *See, e.g.*, Allan E. Anderson, *California Comes Clean: State Requires Disclosure of Chemicals in Cleaning Products*, ARENT FOX (Oct. 17, 2017), https://www.arentfox.com/perspectives/alerts/california-comes-clean-state-requires-disclosure-chemicals-cleaning-products [https://perma.cc/E2HN-WS9H].

making.[305] As a result, like the contracts themselves, disclosures often remain unread.[306]

Proportional Contracts would improve mandatory disclosures if sellers were taxed for the consumer attention cost of the disclosure as well as the contract. Taxing sellers for consumer attention used by disclosures would incentivize sellers to only disclose when the underlying facts require disclosure rather than to disclose excessively regardless of underlying facts. This would make disclosures more informative and less burdensome. In addition, sellers would have incentives to work with regulators to craft disclosures that are simpler and easier for consumers to understand. Currently, sellers wishing to withhold information *benefit* from overly complex disclosures because they overwhelm consumers and are not read. Similarly, if sellers are required to disclose default rules, these disclosures could be included in the tax to prevent excessive disclosures.

To prevent sellers from undermining disclosures by reducing their information content excessively, the comprehension test used to set the tax could include a test of consumer comprehension of the information that regulators intend to convey through the disclosure.

At first blush, it may seem unfair for regulators to first require sellers to include disclosures and to then charge sellers a fee for doing so. But mandates that impose costs and fees are routinely used as a policy tool in other contexts. For example, corporations must register to operate within a jurisdiction and must also pay fees to do so. Similarly, professionals who require licenses to practice their trade must pay for testing, continuing education, and licensing fees.

E. READABILITY REFORMS: SIMPLIFICATION AND PLAIN ENGLISH RULES

Regulators may require that contracts or disclosures be written in simple, easy-to-read language with a minimum of jargon and shorter, simpler

305. BEN-SHAHAR & SCHNEIDER, *supra* note 18, at 17; Loewenstein et al., *supra* note 35, at 410–11. *See generally* Joshua Mitts, *How Much Mandatory Disclosure is Effective?* (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2404526 [https://perma.cc/9X2D-3NSD] (finding that a long list of disclosures can induce cognitive overload); *cf.* Christin Jolls, *Product Warnings, Debiasing, and Free Speech: The Case of Tobacco Regulation*, 169 J. INSTITUTIONAL & THEORETICAL ECON. 53 (2013) (finding that simple, graphic warnings on packaging can be effective in increasing consumer perceptions of health risks associated with cigarette smoking).

306. *Id. See generally* Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707 (2006) (arguing that the disclosures mandated by federal law for home loans do not effectively facilitate price shopping); Marotta-Wurgler, *supra* note 19 (arguing, based on a large-scale empirical study, that disclosure duties are unlikely to change contracting practices); Benoliel & Becher, *supra* note 50 (recommending that lawmakers "impos[e] a general readability duty on consumer contract drafters" that is measured using commonly recognized standards of readability).

sentences.[307] These rules are common in securities regulation,[308] insurance,[309] and privacy regulations.[310] There is evidence that Plain English rules can change writing styles, at least in the securities regulation context.[311] Relatedly, Russell Korobkin has proposed reducing the number of dimensions within contracts to simplify them and increase consumer comprehension.[312]

Proportional contracts would complement readability reforms because sellers would have financial incentives to make their contracts simpler and easier to read. Whereas readability reforms alone might simplify a handful of disclosures in a world of disclosure overload, Proportional Contracts would effect system-wide change.

Comprehensively applied readability reforms might underperform compared to Proportional Contracts because readability reforms rely on regulatory fiat whereas Proportional Contracts uses incentives to harness market forces. In particular, Proportional Contracts taxes sellers more heavily for presenting contracts that are costlier for consumers to read and understand, thereby incentivizing sellers to draft shorter and simpler contracts, especially for lower value transactions. Moreover, Proportional Contracts can also be combined with payments to consumers to read and assess contracts. Readability reforms have at times helped, but still often fall short of encouraging a substantial number of consumers to read or enabling them to understand contracts.[313]

F. REASONABLE EXPECTATIONS DOCTRINE

Courts sometimes interpret ambiguous contract terms in accordance with consumers' "reasonable expectations."[314]

The "reasonable expectations" doctrine introduces substantial unpredictability and administrative costs into contractual interpretation. First, as noted above, it is often difficult for courts to determine consumers'

307. Richard C. Wydick, *Plain English for Lawyers*, 66 CALIF. L. REV. 727, 727–28 (1978).

308. Kenneth B. Firtel, *Plain English: A Reappraisal of the Intended Audience of Disclosure under the Securities Act of 1933*, 72 S. CAL. L. REV. 851, 851 (1999); Tim Loughran & Bill McDonald, *Regulation and Financial Disclosure: The Impact of Plain English*, 45 J. REG. ECON. 94, 96–97 (2014).

309. Loughran & McDonald, *supra* note 308, at 105; Richard Thomas, *Plain English and the Law*, STATUTE L. REV. 139, 140–44 (1985).

310. Omri Ben-Shahar & Adam Chilton, *Simplification of Privacy Disclosures: An Experimental Test*, 45 J. LEGAL STUD. S41, S52–S53 (2016).

311. Loughran & McDonald, *supra* note 308, at 108.

312. Korobkin, *Bounded Rationality*, *supra* note 86, at 1253–54.

313. Ben-Shahar & Chilton, *supra* note 310, at S42, S53 (finding that consumers spend too little time to read even simplified disclosures); Robert A. Hillman, *Online Boilerplate: Would Mandatory Website Disclosure of E-Standard Terms Backfire?*, 104 MICH. L. REV. 837, 841 (2006).

314. *See, e.g.*, Robert E. Keeton, *Insurance Law Rights at Variance with Policy Provisions*, 83 HARV. L. REV. 961, 967 (1970). This "reasonable expectations" doctrine typically applies in the context of insurance contracts *See, e.g.*, Avraham, *supra* note 81, at 65.

reasonable expectations.[315] Expectations may vary among consumers. Specific interactions with the seller, such as oral representations, may or may not be viewed as changing consumers' expectations.[316] The written contract itself may or may not be viewed as changing consumers' expectations.[317] As a descriptive matter, consumers may not form expectations about a specific aspect of the transaction because they are not familiar with highly technical contracts.[318]

It is hard to know how unexpected a term must be to be considered as conflicting with consumers' reasonable expectations.[319] Thus, judicial application of the "reasonable expectations" doctrine is likely informed by judges' idiosyncratic views about the minimal protections that should be accorded to consumers.

Proportional Contracts would likely reduce the use of the reasonable expectations doctrine because sellers would be incentivized to draft shorter, clearer contracts. Because gaps would likely be filled through default rules, and those default rules would become clearer over time through iterative revision and interpretive case law, gap filling would also become more predictable and less administratively burdensome.

G. OTHER PROPOSED REFORMS

In this Section, we consider the compatibility of Proportional Contracts with other prominent proposals that have not yet been widely adopted.

1. "Warning Box" for unexpected terms

Ian Ayres and Alan Schwartz have recently proposed to require sellers to use a short and simplified FTC-approved "warning box" that would focus only on terms that differ from consumers' typical expectations.[320] To verify what consumers expect, the authors suggest that sellers conduct "term-substantiation" surveys of consumers.[321] Courts sometimes replace contract terms with what consumers could have *reasonably* expected, with reasonableness informed by judges' views of fairness. Ayres and Schwartz

315. *See, e.g.*, Ben-Shahar & Strahilevitz, *supra* note 205, at 316–17.

316. *See* Mita Sujan, James R. Bettman & Harish Sujan, *Effects of Consumer Expectations on Information Processing in Selling Encounters*, 23 J. MKTG RSCH. 346, 352 (1986).

317. Stephen J. Ware, *A Critique of the Reasonable Expectations Doctrine*, 56 U. CHI. L. REV. 1461, 1467 (1989).

318. Jeffrey E. Thomas, *An Interdisciplinary Critique of the Reasonable Expectations Doctrine*, 5 CONN. INS. L.J. 295, 319–21 (1998).

319. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1270–71.

320. Ayres & Schwartz, *supra* note 41, at 548 n.9 (2014) ("Courts have routinely relied upon the duty to read doctrine in enforcing contracts."). For a similar proposal, see Lior Jacob Strahilevitz & Jamie Luguri, *Consumertarian Default Rules*, 82 L. & CONTEMP. PROBS. 139, at 156–59 (2019).

321. Ayres & Schwartz, *supra* note 41, at 554.

propose that courts enforce terms that are sufficiently compatible with consumers' *actual* expectations.[322]

Proportional Contracts complements Ayres & Schwartz's proposal: both aim to shorten and simplify contracts. If the Ayres & Schwartz warning box is the most efficient way to convey the terms of the contract to consumers, then sellers could voluntarily adopt this approach to reduce their tax burden. In addition, sellers would determine the most efficient length for the warning box. Since sellers would be taxed based on contractual complexity, they would no longer have incentives to use the full warning box when a shorter, simpler contract would suffice.

In addition, sellers would likely converge on using defaults for many terms not specified in the box. Thus, consumer expectations could be reset to align with the default rules, thereby simplifying administration.

An advantage of our approach is that default rules are set through a political process incorporating representation from both sellers and consumers. Because consumer expectations are amorphous[323] a solution that solely relies on those expectations may offer consumers limited protection. Consumer expectations are formed through interactions with sellers and can therefore be set lower over time by sellers.[324] Thus, whereas the Ayres & Schwartz proposal could still effectively empower sellers to act as private legislatures with respect to gap filling, our proposal requires a more inclusive process to set defaults.

2. Regulatory Pre-Approval of Contracts

Several scholars have proposed that regulators should pre-screen consumer contracts, and that contracts should only be used after approval by regulators.[325] Under many of these proposals, such review would focus on the substance of contracts, rather than on their length and complexity. By striking out one-sided terms deemed by regulators to go too far, regulators would effectively set a ceiling on the most pro-seller contract possible, but below this ceiling, sellers would still have discretion.

With a pre-approval mechanism without Proportional Contracts, sellers will likely try to obtain approval for longer, more complicated, and presumably more pro-seller contracts. In a world with both pre-approval and Proportional Contracts, sellers would have an incentive to limit the length and complexity of the subset of contracts that would be submitted to regulators

322. *Id.*

323. *See* Korobkin, *Bounded Rationality*, *supra* note 86, at 1270–71.

324. *See* Sujan et al., *supra* note 316, at 352; Ayres & Schwartz, *supra* note 41, at 606.

325. Posner & Weyl, *supra* note 291, at 1348–49; Clayton P. Gillette, *Pre-Approved Contracts for Internet Commerce*, 42 HOUS. L. REV. 975, 995–98 (2005); Yehuda Adar & Shmuel I. Becher, *Ending the License to Exploit: Administrative Oversight of Consumer Contracts*, B.C. L. REV. (forthcoming 2022) (manuscript at 49–51), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3720946 [https://perma.cc/QH3W-LBG8].

for review. Sellers will therefore self-police and submit shorter and simpler contracts for review. In addition to the tax, a market for terms generated by shorter, more comprehensible contracts, would also encourage sellers to self-police. This self-policing by sellers, and by reading consumers, could reduce the burden on regulators and lead to more efficient contracts. Thus, the tax will conserve regulatory resources in addition to consumer attention.

3. Limiting the Duty to Read

Arguably, the underlying problem of sellers' over-use of consumer attention comes from the "duty to read" doctrine, which binds consumers to contracts they signed, whether or not they have read them. This implies that another solution would be to limit or abolish the duty to read.

For example, if courts determined that consumers do not have a duty to read beyond a certain length, sellers would have an incentive to make their contracts shorter and simpler, and probably to also put the most important information first. However, this approach would impose high concentrated costs on sellers who would be deemed *ex post* to have exceeded the allowed limit. In contrast, Proportional Contracts would impose lower and more predictable costs on the broad group of sellers who use up consumer attention. Viewed from this framework, Proportional Contracts could be seen as insurance against judicial intervention to invalidate contractual terms. In addition, Proportional Contracts would rely on market forces to limit contractual length and complexity rather than courts. Proportional Contracts would apply to all contracts, and not just those that are the subject of litigation, thereby allowing a more comprehensive solution. In addition, in each case, Proportional Contracts would provide a more tailored, context-specific solution. Thus, we view Proportional Contracts as a substitute, rather than as a complement to relaxing the duty to read.

H. SUMMARY

Our Proportional Contracts proposal generally complements and enhances existing efforts to police consumer contracts. This is because, unlike these other solutions, ours forces sellers to internalize the reading and comprehension costs they impose on consumers through their contracts. While other solutions either rely on providing consumers with more information or on substantive interventions in the contents of standardized agreements, Proportional Contracts incentivizes sellers to draft leaner, simpler contracts, thereby enabling market competition for terms.

V. CONCLUSION

Many legal scholars, regulators, elected officials, and consumer advocates have noted consumers' limited ability to read and understand standard form contracts. Some have suggested ways of reducing reading costs to consumers. However, to the best of our knowledge, this Article is the first to propose to

make sellers pay for the demands their contracts place on consumers' attention.

We propose mechanisms to estimate these attention costs and to charge these back to sellers. Making sellers internalize these costs would incentivize them to limit contractual length and complexity to the optimal level. To deviate from defaults, sellers will have to pay a Pigouvian tax that will rise in proportion to the amount of consumer attention they use up.

We also propose a mechanism to improve default rules so that they will likely be more efficient than unilaterally drafted terms that consumers do not read. Our approach focuses on improving process, with the expectation that, with better process, market forces will improve contracts' substance. This restores consumer contracting practice to the classic understanding of contracts as products of mutual agreement.

A major advantage of our proposal is that it requires relatively little regulatory expertise regarding the *social benefits* of customizing contracts or the optimal length or complexity of any given contract. Our approach also strikes a balance between freedom of contract and consumer protection by permitting sellers to customize their contracts while setting background conditions so that competition will channel those contractual innovations in a prosocial direction.