

# Legal Ignorance and Information-Forcing Rules

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## LEGAL IGNORANCE AND INFORMATION-FORCING RULES

J.H. VERKERKE\*

### ABSTRACT

*People are often ignorant about the legal rules that govern the most common transactions in their lives. This Article analyzes one common regulatory response to our widespread legal ignorance. A surprisingly broad range of legal rules have the ostensible purpose of inducing sophisticated parties to draft express contract language that will inform their contractual partners about the legal rules governing a particular transaction. However, this “legal-information-forcing” objective often remains unrealized because people routinely sign contracts without reading and understanding their terms. In theory, courts could design information-forcing rules that would be truly informative. But recognizing the potential futility of attempts to inform many contracting parties about complex legal rules, this Article also develops and critiques several alternative justifications for “clause-forcing” rules that encourage sophisticated parties to draft express contract terms. Such terms could facilitate the activities of avid comparison shoppers, reviewers, and consumer advocates. Comprehensive written terms also may promote ex post legal clarity and thereby reduce the costs of resolving disputes. Finally, exculpatory clauses allow parties to contract out of the comparatively expensive legal system of dispute resolution in favor of a regime governed by*

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*informal social norms. On this account, clause-forcing rules encourage sophisticated drafting parties to signal their preference for a norm-governed relationship, and lawmakers then demarcate the boundary between law and norms by deciding whether to enforce exculpatory clauses. The normative desirability of these clause-forcing rules is unclear, but my exploration of these alternative justifications shows the conceptual poverty of accounts that presume express contract terms inform the majority of unsophisticated parties.*

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## INTRODUCTION

People are often ignorant about the legal rules that govern the most common transactions in their lives.<sup>1</sup> Whether purchasing products and services, leasing real estate, obtaining insurance, borrowing money, or finding employment, many laypeople have a surprisingly poor grasp of basic legal principles.<sup>2</sup> Of course, this ignorance usually causes no harm. We buy what we need and work until retirement without becoming embroiled in legal disputes. But sometimes people involved in conflicts over defective products, unpaid insurance claims, loan defaults, or employment terminations must assert legal rights or defenses, and some of them ultimately resort to litigation. In circumstances like these, having too little legal knowledge can be dangerous. Legal ignorance potentially distorts important economic decisions. Without a clear understanding of their legal rights and responsibilities, some consumers will mistakenly agree to exculpatory contract terms. Borrowers will accept harsh credit terms. And employees will rely on illusory promises of job security.

Lawmakers have sometimes attempted to combat informational problems such as these by enacting rules that directly mandate disclosure. The federal Truth in Lending Act, for example, requires lenders to disclose interest rates and fees in a statutorily prescribed way.<sup>3</sup> Whenever an employer uses an outside firm to check a job applicant's background, it must disclose that fact and obtain consent from the applicant under provisions of the Fair Credit Reporting

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1. See, e.g., ROBERT C. ELLICKSON, ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES 144-45 (1991) (reviewing evidence of legal ignorance in numerous studies).

2. See, e.g., Martha William & Jay Hall, *Knowledge of the Law in Texas: Socioeconomic and Ethnic Differences*, 7 L. & SOC'Y REV. 99, 113 (1972) (reporting interview respondents did, at best, slightly better than chance when answering yes-or-no questions about Texas civil law); Note, *Legal Knowledge of Michigan Citizens*, 71 MICH. L. REV. 1463, 1468 (1973) (reporting substantial ignorance of Michigan law, including consumer law).

3. See 15 U.S.C. § 1601 (2012). For controversy concerning damages under the Act, see *Koons Buick Pontiac GMC, Inc. v. Nigh*, 543 U.S. 50, 53 (2004). For commentary critical of mandatory disclosure duties in general and Truth in Lending Act requirements in particular, see OMRI BEN-SHAHAR & CARL E. SCHNEIDER, MORE THAN YOU WANTED TO KNOW: THE FAILURE OF MANDATED DISCLOSURE (2014); and Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 679-729 (2011).

Act.<sup>4</sup> And regulations issued by the Securities and Exchange Commission compel issuers to publish exhaustive prospectuses when they offer stock for sale.<sup>5</sup> A voluminous scholarly literature debates whether the informational value of such mandated disclosures exceeds their cost.<sup>6</sup> My focus here, however, is not on these explicit disclosure regulations.

Instead, this Article analyzes a different regulatory response to our widespread legal ignorance. It explores how the law encourages sophisticated parties to provide legal information to the comparatively poorly informed individuals with whom they do business. Many rules in surprisingly diverse fields of law impose unfavorable default terms on sellers, employers, insurers, and other comparatively sophisticated parties, but allow those parties to opt out of these default terms by drafting contract terms that meet certain standards for clarity. Thus, for example, a clear statement disclaiming the implied warranty of merchantability negates that default provision of the Uniform Commercial Code.<sup>7</sup> Likewise, an employer can defeat most implied contract claims of unjust discharge by requiring new employees to sign an express confirmation of at-will status.<sup>8</sup>

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4. See 15 U.S.C. § 1681a (2012).

5. See 12 C.F.R. § 16.3 (2014).

6. See, e.g., BEN-SHAHAR & SCHNEIDER, *supra* note 3, at 6-7; Ben-Shahar & Schneider, *supra* note 3, at 651; Henry T.C. Hu, *Illiteracy and Intervention: Wholesale Derivatives, Retail Mutual Funds, and the Matter of Asset Class*, 84 GEO. L.J. 2319, 2376-77 (1996) (arguing that despite investors' lack of reliance on disclosures, "investor education and more comprehensible forms of mandated disclosure are worthwhile"); Lewis Mandell, *Consumer Perception of Incurred Interest Rates: An Empirical Test of the Efficacy of the Truth-in-Lending Law*, 26 J. FIN. 1143, 1153 (1971); 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, 668-71 (1979); William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400, 403-04; Lauren E. Willis, *Against Financial-Literacy Education*, 94 IOWA L. REV. 197, 201-02 (2008).

7. See U.C.C. § 2-314 (2012) (imposing implied warranty of merchantability as a default term "if the seller is a merchant with respect to goods of that kind"); *id.* § 2-315 ("Where the seller at the time of contracting has reason to know any particular purpose for which the goods are required and that the buyer is relying on the seller's skill or judgment to select or furnish suitable goods, there is unless excluded or modified under the next section an implied warranty that the goods shall be fit for such purpose."); *id.* § 2-316(3)(a) ("[A]ll implied warranties are excluded by expressions like 'as is', 'with all faults' or other language which in common understanding calls the buyer's attention to the exclusion of warranties and makes plain that there is no implied warranty.").

8. See, e.g., *Reid v. Sears, Roebuck & Co.*, 790 F.2d 453, 462 (6th Cir. 1986) (enforcing

I argue here that we can best understand these and other rules as particular instances of an approach that contract theorists have dubbed “information-forcing” or “penalty defaults.”<sup>9</sup> Originating in modern scholarly efforts to justify the famous rule of *Hadley v. Baxendale*, the information-forcing framework uses an unfavorable default to redress problems of asymmetric information between the parties to a contract.<sup>10</sup> Lawmakers select a default rule that disadvantages the better informed party. In order to escape the unfavorable default, the informed party must disclose information to her less well-informed contractual partner. The canonical information-forcing default in *Hadley* thus limits a party’s consequential damages for breach unless she discloses any special circumstances that may cause unusual losses.<sup>11</sup>

This concept extends quite naturally from information about potential consequential losses from breach to situations in which the parties have an asymmetric understanding of the legal rules governing their relationship. Unfavorable default rules encourage legally sophisticated parties to contract expressly for their preferred terms. At least in theory, these express contract terms could inform unsophisticated parties about the law. Many courts and legislators have formulated default rules with legal-information-forcing concerns

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an employee handbook provision that confirmed employees’ at-will status and restricted authority to modify the contractual terms of employment). See generally J.H. Verkerke, *The Story of Woolley v. Hoffmann-La Roche: Finding a Way to Enforce Employee Handbook Promises*, in *EMPLOYMENT LAW STORIES* 23, 64 (Samuel Estreicher & Gillian Lester eds., 2007).

9. See Ian Ayres & Robert Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 *YALE L.J.* 87, 91 (1989) (coining the term “penalty default” to refer to contract rules establishing a default that one or both parties will find unappealing in order to create an incentive to disclose information or to bargain); John H. Barton, *The Economic Basis of Damages for Breach of Contract*, 1 *J. LEGAL STUD.* 277, 295-96 (1972) (arguing for the first time that the *Hadley* rule of foreseeability promotes efficiency by creating an incentive to disclose information about expected damages); Charles J. Goetz & Robert E. Scott, *Enforcing Promises: An Examination of the Basis of Contract*, 89 *YALE L.J.* 1261, 1299-1300 (1980) (identifying how the default rule excluding unforeseeable consequential damages could promote efficiency by encouraging parties to exchange information about the expected losses from breach).

10. 156 Eng. Rep. 145, 151; 9 Ex. 341, 355 (1854).

11. See *id.* at 151 (limiting damages to those that “may fairly and reasonably be considered either arising naturally, i.e., according to the usual course of things, ... or such as may reasonably be supposed to have been in the contemplation of both parties, at the time they made the contract, as the probable result of the breach of it”).

such as these in mind.<sup>12</sup> Judges worry, for example, that workers will overestimate the extent of their contractual protection against discharge.<sup>13</sup> In response, courts have adopted default rules of interpretation that encourage employers to contract expressly for an at-will relationship.<sup>14</sup> Similarly, the drafters of the Uniform Commercial Code sought to protect consumers who might otherwise misunderstand the extent of their rights against the seller of a defective product.<sup>15</sup> Section 2-316 thus establishes a warranty of merchantability as a default term, and permits sellers to avoid granting that warranty only by including a sufficiently clear disclaimer in the sales documents.<sup>16</sup> As one might expect, employers and product manufacturers routinely opt out of these default rules.<sup>17</sup> They craft express contract language that simultaneously protects

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12. See *infra* Part II.B.

13. See, e.g., *Woolley v. Hoffmann-La Roche, Inc.*, 491 A.2d 1257, 1264-65, 1269, *modified*, 499 A.2d 515 (N.J. 1985) (holding that employee handbook would be construed “in accordance with the reasonable expectations of the employees,” finding that “it would be almost inevitable for an employee to regard it as a binding commitment, legally enforceable, concerning the terms and conditions of his employment,” and chastising the employer for “circulat[ing] a document so likely to lead employees into believing they had job security”).

14. See *infra* Part I.D.1. For earlier suggestions that these employment contract doctrines might serve a legal-information-forcing function, see J. Hoult Verkerke, *An Empirical Perspective on Indefinite Term Employment Contracts: Resolving the Just Cause Debate*, 1995 WIS. L. REV. 837, 885; Verkerke, *supra* note 8, at 24, 64.

15. See U.C.C. § 2-316 cmt. 1 (2012) (“[This section] seeks to protect a buyer from unexpected and unbargained language of disclaimer by denying effect to such language when inconsistent with language of express warranty and permitting exclusion of implied warranties only by conspicuous language or other circumstances which protect the buyer from surprise.”).

16. See *id.* § 2-316.

17. See Robert W. Gomulkiewicz, *The Implied Warranty of Merchantability in Software Contracts: A Warranty No One Dares to Give and How to Change That*, 16 J. MARSHALL J. COMPUTER & INFO. L. 393, 398-99 (1997) (noting that parties routinely avail themselves of the warranty disclaimer provisions of the U.C.C.); Florencia Marotta-Wurgler, *Competition and the Quality of Standard Form Contracts: The Case of Software License Agreements*, 5 J. EMPIRICAL LEGAL STUD. 447, 450 (2008) (documenting terms of 647 software license agreements); Yvonne W. Rosmarin, *Consumers-R-Us: A Reality in the U.C.C. Article 2 Revision Process*, 35 WM. & MARY L. REV. 1593, 1610 & n.67 (1994) (“Disclaimers of warranties in consumer sales transactions are used so frequently that the absence of disclaimers is conspicuous. In fact, the typical clause disclaiming implied warranties often attempts to disclaim any express warranties as well, contrary to the express language of § 2-316(1).”); Verkerke, *supra* note 14, at 867-68, 873 (finding that 52 percent of all surveyed employers, and 66 percent of those who had terms governing discharge, contracted expressly for an at-will relationship).



their interests and, at least in theory, informs consumers and workers of the legal rule that will govern their relationship.

As these examples illustrate, legal-information-forcing rules have a common structure. First, the ostensible purpose of the rule is to encourage legally sophisticated parties to inform comparatively unsophisticated parties about their legal rights and obligations. Second, each is a default term designed to favor the interests of the unsophisticated party. Finally, the overwhelming majority of sophisticated parties respond to the rule by contracting around the default, adding language to the contract that better protects the interests of the drafter. What therefore distinguishes a legal-information-forcing rule from other defaults is (1) its goal of dispelling legal ignorance, (2) the fact that the rule initially favors the less sophisticated party, and (3) the frequency of opt-outs.

Rules of this type are remarkably ubiquitous.<sup>18</sup> I argue, however, that there are good reasons to doubt that many achieve their goal of informing unsophisticated parties about the law. These rules instead generate a profusion of boilerplate language in largely unread contract documents. In fact, most people fail most of the time to read most of the terms in the contracts they sign.<sup>19</sup> As a result, a legal-information-forcing strategy seems unlikely to succeed.

We can easily imagine regulatory innovations designed to make the contracting process more informative. Lawmakers could impose procedural requirements for opting out of the default rule in an

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18. See *infra* Part I.D (describing examples of legal-information-forcing rules).

19. See, e.g., NANCY S. KIM, WRAP CONTRACTS: FOUNDATIONS AND RAMIFICATIONS 3 (2013) (criticizing the modern tendency to enforce unread click-wrap and browse-wrap contract terms); MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW 12-14 (2013) (arguing that boilerplate terms go unread and that this fact vitiates consumer consent to those terms); Yannis Bakos et al., *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. LEGAL STUD. 1, 1 (2014) (documenting that “only one or two of every 1,000 retail software shoppers access the license agreement and that most of those who do access it read no more than a small portion”); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1173, 1179 (1983) (“[T]he adhering party is in practice unlikely to have read the standard terms before signing the document and is unlikely to have understood them if he has read them. Virtually every scholar who has written about contracts of adhesion has accepted the truth of this assertion, and the few empirical studies that have been done have agreed.”); Elisabeth Leamy, *Savvy Consumer: Read Your Contract's Fine Print*, ABC NEWS (Aug. 18, 2006), <http://abcnews.go.com/Business/CreativeConsumer/story?id=2325920> [<http://perma.cc/TKR4-BCVR>].

attempt to force laypeople to pay more attention to specific terms.<sup>20</sup> For example, many courts emphasize considerations such as typographical prominence, separate signing, and linguistic clarity in deciding whether to enforce terms that displace a legal-information-forcing default.<sup>21</sup> Lawmakers could adopt even more aggressive approaches, such as requiring an oral recitation of all or part of the contract, quizzing parties about their understanding of key contract terms, or perhaps mandating the participation of an attorney in certain transactions. Careful empirical study might even help us determine which, if any, of these requirements are effective. However, people are often rationally ignorant about contract terms. In these circumstances, the cost of calling their attention to specific terms quickly overwhelms any potential benefit from being better informed. Thus, no cost-effective strategy is likely to make these express terms truly informative for the majority of unsophisticated parties.

This rather pessimistic assessment of legal-information-forcing rules suggests that courts and legislators may be mistaken to rely on them to combat legal ignorance. In short, the conventional information-forcing justification for these rules is unpersuasive. But perhaps legal-information-forcing defaults can be explained and justified on other grounds. Part III of this Article recasts the rules as “clause-forcing” and explores several alternative accounts of how

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20. For an example of such a proposal in the context of employment contracting, see Cynthia L. Estlund, *How Wrong Are Employees About Their Rights, and Why Does It Matter?*, 77 N.Y.U. L. REV. 6, 8, 26 (2002) [hereinafter Estlund, *How Wrong Are Employees*]; and Cynthia L. Estlund, *Just the Facts: The Case for Workplace Transparency*, 63 STAN. L. REV. 351, 363-69 (2011) [hereinafter Estlund, *Just the Facts*]. For a more pessimistic assessment of a similar effort focused on consumer lending, see Willis, *supra* note 6, at 201-02, 264.

21. See, e.g., *Jones v. Cent. Peninsula Gen. Hosp.*, 779 P.2d 783, 788 (Alaska 1989) (refusing to enforce one-sentence handbook disclaimer because it was insufficiently conspicuous); *McDonald v. Mobil Coal Producing, Inc.* 789 P.2d 866, 870-71 (Wyo. 1990) (Golden, J., concurring) (emphasizing that the company’s disclaimer of just cause protection was not capitalized and that it was located in a general welcoming section of the handbook). The movement to promote or require consumer contracts to be formulated in “plain language” aims in a similar direction. See, e.g., N.Y. GEN. OBLIG. LAW § 5-702 (McKinney 2014) (“[A plain language requirement is imposed on written agreements] for the lease of space to be occupied for residential purposes, for the lease of personal property to be used primarily for personal, family or household purposes or to which a consumer is a party and the money, property or service which is the subject of the transaction is primarily for personal, family or household purposes.”); 37 PA. CODE §§ 307.1-307.10 (1999) (imposing a pre-approval requirement for certain consumer contracts and establishing standards of review for readability).

the resulting express contract terms might serve socially beneficial purposes.<sup>22</sup>

First, these rules may produce express contract terms that inform an important subset of parties. For example, easy access to detailed contract terms could facilitate the activities of avid comparison shoppers, consumer advocates, and reviewers. Their scrutiny of these terms may indirectly benefit the majority of unsophisticated parties who elect not to read the contract.<sup>23</sup> Alternatively, the express terms may be valuable only after a dispute has arisen. The more detailed contract language could increase the ex post clarity of the parties' legal rights and thus lower dispute resolution costs.<sup>24</sup> Or finally, and most controversially, these exculpatory terms may be an effort on the part of sophisticated parties to replace legal enforcement of the parties' rights with a norm-governed system that operates largely outside of the traditional legal system.<sup>25</sup> Thus, parties may rely on informal market norms to enforce their commitments with less certainty, but more cheaply, than through litigation. These cost savings potentially produce higher profits for firms, lower prices for consumers, and increased wages for workers. On this account of clause-forcing defaults, the role of the judiciary is simply to decide when exculpatory language goes too far. Courts

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22. Part III also discusses how legal-information-forcing rules are related to the large and growing literature that proposes to use "sticky" default rules to shift contract terms and behavior in socially desirable ways. See, e.g., MICHAEL S. BARR ET AL., AN OPT-OUT HOME MORTGAGE SYSTEM (2008); RICHARD H. THALER & CASS R. SUNSTEIN, NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008); Cass R. Sunstein, *Human Behavior and the Law of Work*, 87 VA. L. REV. 205, 207, 224 (2001) [hereinafter Sunstein, *Human Behavior*]; Cass R. Sunstein, *Switching the Default Rule*, 77 N.Y.U. L. REV. 106 (2002) [hereinafter Sunstein, *Switching the Default Rule*]. For a more critical assessment of this strategy, see Lauren E. Willis, *When Nudges Fail: Slippery Defaults*, 80 U. CHI. L. REV. 1155, 1227 (2013).

23. See *infra* notes 202-03 and accompanying text. See generally Schwartz & Wilde, *supra* note 6.

24. See *infra* Part III.C.

25. See *infra* Part III.D. See generally ELLICKSON, *supra* note 1; Lisa Bernstein, *Opting Out of the Legal System: Extra-Legal Contractual Relations in the Diamond Industry*, 21 J. LEGAL STUD. 115 (1992) [hereinafter Bernstein, *Opting Out*]; Lisa Bernstein, *Private Commercial Law in the Cotton Industry: Creating Cooperation Through Rules, Norms, and Institutions*, 99 MICH. L. REV. 1724 (2001) [hereinafter Bernstein, *Creating Cooperation*]; Stewart Macaulay, *Non-Contractual Relations in Business: A Preliminary Study*, 28 AM. SOC. REV. 55 (1963); Barack D. Richman, *How Communities Create Economic Advantage: Jewish Diamond Merchants in New York*, 31 LAW & SOC. INQUIRY 383 (2006).

must determine whether public policy requires certain legal liabilities to persist despite the efforts of sophisticated parties to exclude them.<sup>26</sup>

A comprehensive positive explanation for the widespread use of clause-forcing rules will likely involve elements of each of these stories. And it is impossible to know whether a particular rule is normatively defensible until we discover what purpose it serves, and how well it achieves that goal. Embracing any of these alternatives, however, has profound implications for the design of the rules themselves. The goal of *ex post* legal clarity, for example, demands only that parties commit their preferred terms to writing and express them clearly.<sup>27</sup> Courts' current preoccupation with prominence and the typographical aspects of express terms is pointless if the terms only have value once a dispute arises. If, however, sophisticated parties use exculpatory clauses principally to substitute norms for law as a means of contract enforcement, then courts need to recognize this motivation and analyze how these clauses affect contractual relations in the relevant market. A deeper understanding of these practices will help lawmakers develop more coherent doctrinal rules to police the line between acceptable reliance on informal norms and objectionably exculpatory contract terms. Although it may be impossible to know whether these clause-forcing rules are normatively desirable, my analysis demonstrates the conceptual poverty of current judicial and legislative approaches that assume these express contract terms inform most parties.

This Article proceeds in three parts. Part I introduces the concept of an information-forcing default rule, shows how that concept applies to the problem of legal ignorance, and offers a number of examples of legal-information-forcing default rules. Part II identifies a significant problem with the conventional information-forcing justification. People often pay no attention to the express contract terms that these rules encourage. It also reviews the existing scholarly literature on disclosure regulations and on adhesion contracts for

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26. The scholarly debate about the proper regulation of boilerplate terms in contracts raises very similar issues. *See, e.g.*, RADIN, *supra* note 19 (arguing that regulatory agencies have fallen short in their oversight of the use of boilerplate clauses); BEN-SHAHAR & SCHNEIDER, *supra* note 3 (discussing the regulation of boilerplate clauses).

27. *See infra* Part III.C.

ideas about how to address this problem. Part III develops and critiques several alternative justifications for the clause-forcing rules on which the Article is focused. This Part also shows that adopting any of these alternative justifications will require courts and commentators to rethink existing doctrinal requirements, and to develop a more nuanced understanding of how clause-forcing defaults affect contracting practices.

#### I. THE PERVASIVENESS OF INFORMATION-FORCING JUSTIFICATIONS

In this Part, I explain the origins of information-forcing contract default rules, extend the basic theory to encompass problems of legal ignorance, reexamine the conventional information-forcing account of the *Hadley* rule, and illustrate how pervasively lawmakers have embraced legal-information-forcing arguments.

##### A. *Origins*

So what precisely is an information-forcing rule? As I will use the term, it is any contract default rule that favors one party in order to induce the other party to a transaction to disclose particular information. If the disfavored party fails to provide the targeted information, then that party suffers a legal disadvantage associated with a comparatively unfavorable default rule. By providing legally adequate disclosure to a transactional partner, however, the disfavored party may escape the undesirable default. This definition thus excludes any law that imposes civil or criminal penalties for nondisclosure.<sup>28</sup> Such affirmative disclosure duties serve a similar purpose but operate through a different mechanism. My focus here is on situations in which disclosing parties may opt into different and more favorable rules by providing the required information to their transactional partner. As we will see, even this restrictive

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28. Examples of direct disclosure duties include Securities and Exchange Commission prospectus requirements, 15 U.S.C. § 77j (2012); 12 C.F.R. § 16.3 (2014), Food and Drug Administration food labeling regulations, 15 U.S.C. § 1453 (2012); 21 C.F.R. § 101.3 (2014), and Employee Retirement Income Security Act rules requiring plan sponsors to provide summary plan descriptions to participants, 29 C.F.R. § 2520.102-3 (2013).

definition encompasses a plethora of judge-made and legislatively enacted rules found in diverse substantive areas of law.<sup>29</sup>

Note that a so-called “penalty default” rule that specifies a term undesirable to both parties also could be used to induce parties to negotiate over that contract term.<sup>30</sup> Although it has become conventional for commentators to refer to both information-forcing and negotiation-forcing rules as “penalty defaults,”<sup>31</sup> the term perhaps makes more sense applied to rules in the latter category that truly penalize both parties for failing to reach an explicit agreement. In the interest of analytical clarity, this Article focuses exclusively on the potential information-forcing function of default rules that favor one party over another.

Although the rules themselves have been around for a long time, academic attention to the theory of information-forcing rules originated among economically oriented scholars examining what is now one of the most thoroughly debated contract doctrines—the foreseeability limitation on consequential damages.<sup>32</sup> Among contemporary contract theorists, the canonical justification for limiting the recovery of consequential damages to those that are foreseeable in the ordinary course of business is an information-forcing rationale.<sup>33</sup> According to this approach, courts presume that both parties know the ordinary damages that are likely to flow from a breach of contract. If, however, “special circumstances” will produce

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29. See *infra* Part I.D.

30. See Ayres & Gertner, *supra* note 9, at 91.

31. See, e.g., Ian Ayres, *Ya-Huh: There Are and Should Be Penalty Defaults*, 33 FLA. ST. U. L. REV. 589, 606 (2006) (noting that environmental regulation standards may act as threat points in negotiations); Bradley C. Karkkainen, *Information-Forcing Environmental Regulation*, 33 FLA. ST. U. L. REV. 861, 865 (2006) (describing the information-forcing character of penalty default rules).

32. For the rule, see *Hadley v. Baxendale*, 156 Eng. Rep. 145, 150-51; 9 Ex. 341, 354-55 (1854). For the academic debate, see, for example, Barry Adler, *The Questionable Ascent of Hadley v. Baxendale*, 51 STAN. L. REV. 1547 (1999) (challenging the significance of the prevailing understanding of the *Hadley* rule); Ayres & Gertner, *supra* note 9 (developing the concept of a “penalty default” rule); Lucian Ayre Bebchuk & Steven Shavell, *Information and the Scope of Liability for Breach of Contract: The Rule of Hadley v. Baxendale*, 7 J.L. ECON. & ORG. 284 (1991) (presenting a model similar to Ayres & Gertner’s explanation for the *Hadley* rule); Goetz & Scott, *supra* note 9 (referring to the information-forcing function of some default rules); Jason Scott Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 YALE L.J. 615 (1990) (questioning whether strategic considerations might prevent buyers from disclosing their private information).

33. See Ayres & Gertner, *supra* note 9, at 101.

greater than ordinary losses, then the party who knows about those circumstances must share that information with the other party prior to contracting.<sup>34</sup> Only after obtaining at least implied consent to bear this additional risk can the better-informed party hope to recover for more than ordinary losses in the event of a contract breach.<sup>35</sup> Thus, the default rule of limited liability encourages one party to reveal information that he or she would rather not disclose.

A real-world example will make this analysis more concrete. Imagine that you are shipping a box of books and a box of diamonds to a dear friend in another state. You deliver both boxes to a common carrier and pay standard shipping charges based on the weight and size of the boxes.<sup>36</sup> If the carrier inadvertently loses one of the boxes in transit, your economic losses depend critically on whether the lost box contained books or diamonds. Under the prevailing default rule for consequential damages, however, your potential recovery is limited to an amount the court considers foreseeable in these circumstances. Ordinary damages would almost surely cover the loss of your books. But a recovery limited to foreseeable consequential damages would protect only a tiny fraction of the value of your diamonds. In order to be compensated fully for the loss of your diamonds, you must therefore inform the carrier of this “special circumstance” at the time of contracting. The carrier in turn will take more appropriate precautions to prevent loss, and will undoubtedly charge you a price sufficient to cover both the cost of those precautions and any residual risk of loss. The limited liability default rule has thus “forced” you to reveal information about the damages you will suffer if the carrier loses your

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34. See *Hadley*, 156 Eng. Rep. at 151.

35. See U.C.C. § 2-715(2)(a) (2012) (allowing recovery of “any loss from general or particular requirements and needs of which the seller at the time of contracting had reason to know”); RESTATEMENT (SECOND) OF CONTRACTS § 351 (1981) (barring recovery “for loss that the party in breach did not have reason to foresee as a probable result of the breach when the contract was made”). Modern courts also apply the *Hadley* rule. See, e.g., *Spang Indus. v. Aetna Cas. & Sur. Co.*, 512 F.2d 365, 368 (5th Cir. 1975); *Turner's Farms, Inc. v. Me. Cent. R.R.*, 486 F. Supp. 694, 699 (D. Me. 1980).

36. I recognize that this scenario omits or misrepresents several important features of real-world shipping contracts. Nevertheless, my description accurately captures the transactional model on which most conventional discussions of the *Hadley* rule rest. I reexamine a more realistic version of this transaction in Part I.C below.

shipment. As a result, the carrier can take efficient precautions and charge you an efficient price for this service.

A considerable literature has explored a variety of difficulties, qualifications, and limitations of this information-forcing rationale for a default rule limiting consequential damages. For example, the “special circumstances” that a party must disclose before contracting may simultaneously reveal important private information about the value of the contract to that party.<sup>37</sup> Someone who informs a prospective contractual partner that a breach will cause unusually large lost profits has also signaled that he or she may be willing to pay an unusually high price for performance. Ordinarily, competition can be expected to drive the contract asking price down to the cost of providing the relevant goods or services plus the cost of bearing any unusual risk of loss from breach. In imperfectly competitive markets, however, these competing strategic considerations discourage disclosure and may diminish the effectiveness of an information-forcing rule.<sup>38</sup>

Eric Posner even goes so far as to question whether penalty default rules exist at all.<sup>39</sup> He directs his criticism principally at Ian Ayres and Robert Gertner’s frequently cited article that first used the term “penalty default” to describe nonmajoritarian rules that have an information-forcing effect.<sup>40</sup> Although Ayres and Gertner applied this concept to a variety of legal rules, the *Hadley* foreseeability limitation on consequential damages motivated their analysis and served as the canonical illustration of a penalty default. Subsequent scholarly discussion of the penalty default theory has similarly focused disproportionate attention on the *Hadley* rule.<sup>41</sup>

According to Posner, however, it is unclear whether even this pivotal example is properly understood as a penalty default.<sup>42</sup> He contends that the foreseeability limitation may instead be majoritarian because carriers have no comparative advantage in providing

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37. See Johnston, *supra* note 32, at 616.

38. See *id.* at 634.

39. Eric A. Posner, *There Are No Penalty Default Rules in Contract Law*, 33 FLA. ST. U. L. REV. 563, 565 (2006).

40. See Ayres & Gertner, *supra* note 9, at 91.

41. See, e.g., Adler, *supra* note 32, at 1548; Johnston, *supra* note 32, at 615.

42. Posner, *supra* note 39, at 574-75.



insurance against lost shipments.<sup>43</sup> Alternatively, Posner suggests that liability for unforeseeable losses would not affect carriers' precautions, and thus carriers need not internalize those costs in order to ensure that they take efficient precautions.<sup>44</sup> He concludes that the *Hadley* rule is not a penalty default either because it is majoritarian or because "it does not reflect the factors in Ayres and Gertner's model."<sup>45</sup> Turning to Ayres and Gertner's other examples of penalty defaults, Posner characterizes some as "legal formalit[ies]," others as "formation doctrines," and still others as "interpretive presumptions."<sup>46</sup> He contends principally that the rules in these distinct doctrinal categories are not defaults because they do not fill gaps in a preexisting contract.<sup>47</sup> Moreover, Posner offers an alternative majoritarian explanation for many of these contract doctrines.

In his response to Posner's criticisms, Ian Ayres observes that Posner's doctrinal formalism obscures the fact that contract formalities, formation doctrines, interpretive presumptions, and conventional default rules are often functionally equivalent.<sup>48</sup> Each of these types of rules selects terms to govern the contractual relationship between two parties. Yet those parties usually remain free to specify explicitly the contract terms that they prefer, or to reject contractual obligations altogether. Ayres maintains that, far from being majoritarian, rules such as *contra proferentem*, which Posner classifies as an interpretive presumption, operate as non-majoritarian, information-forcing defaults.<sup>49</sup> Indeed, Ayres equates information-forcing and penalty defaults and offers a ten-page litany of quotes from scholars who have used one or both terms to describe a breathtaking variety of legal rules.<sup>50</sup>

Turning to *Hadley* itself, Ayres acknowledges that it "is not the cleanest example of a penalty default" because it does not "induc[e]

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43. *Id.* at 575.

44. *Id.*

45. *Id.* at 574.

46. *Id.* at 576-78.

47. *Id.* at 566-67.

48. Ayres, *supra* note 31, at 617.

49. *Id.* at 596.

50. *Id.* at 601-11.

a majority of contractors to contract around the default,”<sup>51</sup> and thus can plausibly be seen as majoritarian.<sup>52</sup> After all, most contracting parties would want a rule that prevents an opportunistic minority from strategically withholding information. In terms of our earlier example, people shipping books have no interest in paying for precautions designed to protect the carrier from losses associated with misplacing the occasional shipment of diamonds. But Ayres argues that the *Hadley* rule remains a “powerful [example of penalty defaults] because its efficiency stems from its inducing some contractors to contract around the default, rather than from enabling parties to save on the costs of contracting around it.”<sup>53</sup>

My own approach to the debate about *Hadley* depends on understanding the case in terms that I develop in the next Section, and thus I revisit *Hadley* immediately thereafter. For the moment, simply note that the information-forcing argument for limited consequential damages is a specific application of the more general principle of comparative advantage.<sup>54</sup> Efficiency-minded courts and commentators select contract default rules by asking which party can more cheaply perform or bear particular risks of nonperformance. The information-forcing argument extends this basic notion of comparative advantage and considers which party is in the best position to disclose information relevant to the transaction. In the context of the *Hadley* rule for consequential damages, it is information about factual circumstances, such as expected lost profits or alternative sources of supply, that the rule encourages one party to disclose. As we will see in the next Section, however, information about the legal rules that govern a transaction can also be the object of information-forcing rules.

### *B. Information-Forcing Theory Applied to Legal Ignorance*

The hoary maxim “ignorance of the law is no excuse” expresses a strong presumption that individuals are adequately informed about

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51. *Id.* at 613.

52. *See id.* at 612; Ian Ayres & Robert Gertner, *Majoritarian vs. Minoritarian Defaults*, 51 STAN. L. REV. 1591, 1606 (1999); Robert E. Scott, *Rethinking the Default Rule Project*, 6 VA. J. 84, 85-86 (2003).

53. Ayres, *supra* note 31, at 612.

54. *See* Goetz & Scott, *supra* note 9, at 1299.

prevailing legal rules.<sup>55</sup> Regardless of whether that presumption is justified in the criminal context from which it arises, abundant empirical evidence reveals widespread ignorance about many aspects of civil law.<sup>56</sup> People often lack basic information about the legal rules governing particular transactions in which they routinely participate. Ignorance about product warranties, termination standards, damage limitations, insurance exclusions, or pension provisions may potentially distort important economic decisions, and could produce serious allocative inefficiency. When people do not know important legal characteristics of the things they buy, their willingness to pay may not accurately reflect their true valuation of those products and services.

The argument for information-forcing default rules suggests a possible solution to this problem of legal ignorance: we could treat legal information just as we do information about the expected consequential damages resulting from a breach of contract. Lawmakers could determine whether one party has a comparative advantage in obtaining and communicating information about the law governing this transaction. If so, a legal-information-forcing rule would force the comparatively better informed party to choose between revealing the relevant legal information or accepting a default rule that favors the less informed party. Such a rule contrasts sharply with a conventional “majoritarian default” selected to mimic the terms that most parties would prefer for this type of transaction. Instead, lawmakers choose the default knowing that the overwhelming majority of well-informed parties will opt out.

A surprisingly large number of common law and statutory rules take this form.<sup>57</sup> They seem designed to force a legally sophisticated party to inform unsophisticated parties about the prevailing legal standard. Judicial opinions and legislation often make this legal-

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55. See *Pope v. Illinois*, 481 U.S. 497, 517 (1987) (Stevens, J., dissenting) (“Under ordinary circumstances, ignorance of the law is no excuse for committing a crime.”); MODEL PENAL CODE § 2.02(2)(d)(9) (1962) (“Neither knowledge nor recklessness or negligence as to whether conduct constitutes an offense or as to the existence, meaning or application of the law determining the elements of an offense is an element of such offense, unless the definition of the offense or the Code so provides.”).

56. See ELLICKSON, *supra* note 1, at 144-45; Austin Sarat, *Support for the Legal System: An Analysis of Knowledge, Attitude and Behavior*, 3 AM. POL. Q. 1, 7 (1975); William & Hall, *supra* note 2, at 114-19; *Legal Knowledge of Michigan Citizens*, *supra* note 2, at 1467-75.

57. See *infra* Parts I.C-D.

information-forcing objective explicit.<sup>58</sup> For other rules, however, an implicit legal-information-forcing rationale is the most plausible explanation for their structure.

All of these legal rules share two common characteristics. First, they are defaults because sophisticated parties may avoid the unfavorable rule by drafting express contract terms, which simultaneously provide legal information to their contractual partners. Second, the best evidence that a rule's primary purpose is to encourage one party to provide legal information to another is the empirical observation that the overwhelming majority of legally sophisticated parties choose to contract around it. Of course, a court might create such a rule in an unsuccessful attempt to identify a majoritarian default.<sup>59</sup> But a more plausible—and more charitable—explanation for default rules subject to routine opt-outs is that the rules aim, at least implicitly, to increase the amount of legal information contained in these contracts.

A legal-information-forcing justification for these default rules also sidesteps one problem that conventional information-forcing arguments must confront. As we saw earlier, the standard economic explanation for the *Hadley* foreseeability limitation rests on the rule's ability to elicit information about the costs of breach from the better informed party.<sup>60</sup> Critics have observed that parties engaged in strategic bargaining may legitimately object to revealing their

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58. See, e.g., *Toussaint v. Blue Cross & Blue Shield*, 292 N.W.2d 880, 894-95 (Mich. 1980) (suggesting that employers could avoid liability by making known to employees that personnel policies are subject to unilateral change by their employer); *Woolley v. Hoffmann-La Roche, Inc.*, 491 A.2d 1257, 1271, *modified*, 499 A.2d 515 (N.J. 1985) (“It would be unfair to allow an employer to distribute a policy manual that makes the workforce believe that certain promises have been made and then to allow the employer to renege on those promises.... [I]f the employer ... does not want the manual to be capable of being construed by the court as a binding contract ... [then the employer should include] an appropriate statement that there is no promise of any kind by the employer contained in the manual.”); *Thompson v. St. Regis Paper Co.* 685 P.2d 1081, 1088 (Wash. 1984) (suggesting that employers could avoid liability by specifically stating “in a conspicuous manner” that contents are not intended to be part of the employment relationship, or by specifically asserting the employer’s right to modify policies); U.C.C. § 2-316 (2012). See generally Verkerke, *supra* note 8, at 25, 51-59 (documenting the legal-information-forcing purpose behind employee handbook doctrine).

59. Or perhaps the court has other purposes in mind such as consumer protection, social justice, or distributional equity. For discussion of majoritarian default rules from an economic perspective, see generally Goetz & Scott, *supra* note 9.

60. See *supra* notes 32-35 and accompanying text.

private value of performance to prospective contractual partners.<sup>61</sup> Sophisticated parties, however, cannot plausibly claim that they have a right to conceal the legal terms governing a transaction. Nevertheless, a critic who sought to encourage self-reliance might contend that a principle of *caveat emptor* should shield parties from any duty to inform their transactional partners about the law. Although such an argument implies that we must decide how best to encourage uninformed parties to learn about the prevailing legal rules, it is difficult to argue that one party should have a right to conceal relevant legal information. An objection on these grounds thus requires us to compare alternative means of conveying legal information, but does not call into question the advisability of making this information available to all.

Despite this apparent advantage, a legal-information-forcing default could create other strategic problems. Sophisticated parties may be reluctant to call attention to exculpatory or self-serving rules by enshrining them in express contract terms. Potential contractual partners—at least those who read the terms before signing the agreement—could interpret such terms as a signal that the contract drafter plans to renege on his or her obligations, or otherwise behave in an uncooperative fashion.<sup>62</sup> However, the informational value of such a signal diminishes significantly when the law strongly encourages one party to contract expressly for any particular advantageous term. Indeed, if the practice of contracting around the default rule becomes nearly universal—as it is in the overwhelming majority of examples discussed below—then this signal no longer distinguishes among possible contractual partners.<sup>63</sup> The danger of adverse signaling thus plays little role in evaluating the costs and benefits of legal-information-forcing default rules.

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61. See Johnston, *supra* note 32, at 616.

62. For examples of suggestions that express contract terms function as signals, see Omri Ben-Shahar & John A.E. Pottow, *On the Stickiness of Default Rules*, 33 FLA. ST. U. L. REV. 651 (2006); and Kathryn E. Spier, *Incomplete Contracts and Signalling*, 23 R. J. ECON. 432 (1992). For an influential application of signaling theory to the employment relationship, see Michael Spence, *Job Market Signaling*, 87 Q.J. ECON. 355 (1973). In a more practice-oriented vein, see Julius M. Steiner & Allan M. Dabrow, *The Questionable Value of the Inclusion of Language Confirming Employment At-Will Status in Company Personnel Documents*, 37 LAB. L.J. 639, 644 (1986).

63. See Willis, *supra* note 22.

### C. *The Hadley Rule Revisited*

So what can the theory of legal-information-forcing defaults tell us about the venerable rule of *Hadley v. Baxendale*? To answer this question, recall our earlier example of shipping a box of books and a box of diamonds.<sup>64</sup> As we saw, the foreseeability limitation arguably “forces” you to reveal information about the damages you will suffer if the carrier loses your shipment of diamonds. It thus allows the carrier to take efficient precautions and charge you an efficient price for the service.<sup>65</sup> Our initial analysis, however, ignored important features of the legal rule and inaccurately described common contracting practices for transactions of this type.

The conventional economic analysis of the *Hadley* foreseeability limitation models the rule as one that awards the normal damages that a low-valuation shipper suffers in the event of breach.<sup>66</sup> In our example, foreseeable damages cover the cost of a box of books but not a box of diamonds. The stark contrast between books and diamonds (or between high-valuation and low-valuation shippers in the conventional model), however, obscures the fact that even the restrictive *Hadley* rule exposes the carrier to an uncertain distribution of damage liability in the event of breach. A fact-finder might conclude on the evidence in a particular case that “normal” or “ordinary” losses include a comparatively high value for the books themselves and perhaps additional consequential damages for any delay in obtaining replacement copies of the books.<sup>67</sup> In contrast, another case might place a comparatively low value on the books and exclude more remote consequential losses entirely.<sup>68</sup> The foreseeability

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64. See *supra* text accompanying notes 36-37.

65. See *supra* text accompanying notes 36-37.

66. See Johnston, *supra* note 32, at 616.

67. Professor Eisenberg, among other scholars, has argued that “the trend of the cases has been to relax the standard of foreseeability required under the principle of *Hadley v. Baxendale*.” Melvin Eisenberg, *The Principle of Hadley v. Baxendale*, 80 CALIF. L. REV. 563, 610 (1992) (citing *Hector Martinez & Co. v. S. Pac. Transp. Co.*, 606 F.2d 106 (5th Cir. 1979); *Wullschleger & Co. v. Jenny Fashions, Inc.*, 618 F. Supp. 373 (S.D.N.Y. 1985); *Prutch v. Ford Motor Co.*, 618 P.2d 657 (Colo. 1980); *Miles v. Kavanaugh*, 350 So. 2d 1090 (Fla. Dist. Ct. App. 1977); *Midland Hotel Corp. v. Reuben H. Donnelley Corp.*, 515 N.E.2d 61 (Ill. 1987); *R.I. Lampus Co. v. Neville Cement Prods. Corp.*, 378 A.2d 288 (Pa. 1977)).

68. For comparatively narrow readings of the *Hadley* rule, see *McMillain Lumber Co. v. First National Bank*, 110 So. 602 (Ala. 1926); *F & B Ceco, Inc. v. Galaxy Studios, Inc.*, 201 So.

rule is thus more “mud” than “crystal” in the evocative terminology often used to describe uncertain standards and precise rules.<sup>69</sup>

The conventional analysis of *Hadley* also presumes that carriers allow low-valuation shippers—those shipping a box of books—to remain silent and accept the default rule of foreseeable damages. Yet anyone who has dealt with UPS or FedEx is surely aware that many express “Terms and Conditions” become part of the written contract. Taking the FedEx “U.S. Airbill” as an example, the face of the form includes a space for “Total Declared Value,” and a fine-print footnote that explains: “Our liability is limited to US\$100 unless you declare a higher value. See back for details. By using this Airbill you agree to the service conditions on the back of this Airbill and in the current FedEx Service Guide, including terms that limit our liability.”<sup>70</sup>

The summary of terms on the reverse side of the Airbill reiterates the \$100 liability limitation and explains additional limits on the maximum allowable declared value.<sup>71</sup> Tellingly, these terms expressly disclaim liability for loss of any kind in excess of the declared value, and they also restrict the maximum declared value to \$1,000 for packages containing “items of extraordinary value,” such as “jewelry” and “precious metals.”<sup>72</sup>

The *Hadley* rule undoubtedly shapes the prototypical modern carriage contract, but not through the mechanism that conventional information-forcing theory proposes. No sensible carrier relies on the foreseeability limitation to protect itself against the excessive damage claims of high-value shippers. Instead, like FedEx, all modern carriers contract expressly for a precise—and far lower—limit on their liability.<sup>73</sup> In addition, carriers offer a menu of options for

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2d 597 (Fla. Dist. Ct. App. 1967); *Marcus & Co. v. K.L.G. Baking Co.*, 3 A.2d 627 (N.J. 1939); *Czarnikow-Rionda Co. v. Fed. Sugar Refining Co.*, 173 N.E. 913 (N.Y. 1930); *Keystone Diesel Engine Co. v. Irwin*, 191 A.2d 376 (Pa. 1963), overruled by *R.I. Lampus Co. v. Neville Cement Products Corp.*, 378 A.2d 288 (Pa. 1977); *Longview Construction & Development, Inc. v. Loggins Construction Co.*, 523 S.W.2d 771 (Tex. Civ. App. 1975); and *Head & Guild Equipment Co. v. Bond*, 470 S.W.2d 909 (Tex. Civ. App. 1971).

69. The seminal invocation of this widely used metaphor is Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577 (1988).

70. FedEx Express New Package U.S. Airbill (revision date 1/2012) (on file with author).

71. *Id.*

72. *Id.*

73. Companies in the moving industry similarly negotiate an express valuation for the

shippers to cover more valuable items at additional cost.<sup>74</sup> For their part, low-value shippers never have an opportunity to accept the default rule of foreseeable damages for loss. Instead, carriers' uniform practice requires shippers either to accept a comparatively low fixed liability limitation or to declare a value and pay for greater coverage.<sup>75</sup>

Considering how thoroughly the *Hadley* example dominates the literature on information-forcing defaults, it may be somewhat surprising to learn that legal-information-forcing theory describes the practical consequences of the *Hadley* rule more accurately than the conventional account. Recall that a legal-information-forcing purpose is often the best explanation for unfavorable default rules from which sophisticated parties routinely opt out.<sup>76</sup> According to the conventional theory, the foreseeability limitation provides sufficient protection for promisors against unreasonable damage claims.<sup>77</sup> Carriers evidently do not share this assessment of the doctrine. Their standard contracting practices reveal that they consider the *Hadley* rule an unfavorable default. It exposes carriers to greater expected liability than they wish to bear, and the uncertainty inherent in a foreseeability analysis simply compounds the problem. Carriers have responded by contracting around this unfavorable default.<sup>78</sup> Nevertheless, no court or legislature has altered the default rule to match what standard industry practice reveals to be the preference of all sophisticated market participants.

What can possibly explain this persistent nonmajoritarian default rule? Ordinarily, carriers are better informed and more legally sophisticated than most of their clients. Thus, one plausible account is that lawmakers intend, or at the very least accept, that the default rule will induce legally sophisticated parties to provide information about the prevailing legal rules to their less knowledgeable

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goods they transport and contractually limit potential recovery for loss or damage to that amount. See, e.g., 5 S.C. JUR. CARRIERS § 51 (discussing common carriers' ability to contractually limit liability).

74. See, e.g., *UPS Air Freight Terms and Conditions of Contract ("Terms") for UPS Air Freight Services in the United States, Canada, and International*, UPS 36 (July 7, 2014), [http://www.ups.com/media/en/AirFreight\\_TandC.pdf](http://www.ups.com/media/en/AirFreight_TandC.pdf) [<http://perma.cc/F46W-ZSLS>].

75. *Id.*

76. See *supra* Part I.B.

77. See *supra* Part I.B.

78. See *supra* notes 73-74 and accompanying text.



contractual partners. Because express liability limitations are so pervasive, courts now rarely, if ever, have an opportunity to discuss how the *Hadley* rule applies to transactions of this type. Nevertheless, the legal-information-forcing theory fits the available facts far better than the conventional information-forcing story. It can explain why legally sophisticated parties routinely opt out, and why courts might believe that the resulting express contract terms are a socially beneficial consequence of this nonmajoritarian default. Moreover, judges have explicitly invoked a legal-information-forcing purpose in adopting other related contract doctrines—such as the *contra proferentem* presumption and unconscionability—that are designed, at least in part, to encourage companies to inform unsophisticated parties about their contractual rights.<sup>79</sup>

My claim is not that the *Hadley* court crafted foreseeability doctrine for its legal-information-forcing effect, nor do I argue that subsequent decisions necessarily rest on that rationale. Instead, I contend that if information-forcing effects explain the *Hadley* rule at all, then it is legal information that the rule itself is forcing. The doctrine induces sophisticated parties to draft express contract terms, and those terms in turn force shippers and other similar parties to disclose their expected loss from breach. The sophisticated parties then use this information to adjust their precautions and pricing according to the level of risk. In contrast, the conventional theory erroneously suggests that the rule itself separates high-valuation from low-valuation shippers.<sup>80</sup>

Finally, it is worth noting that the *Hadley* rule also supplies the default damage rule for transactions outside of the shipping context on which we have focused. But the rule itself, as opposed to the express liability limitations it engenders, determines damages in a surprisingly narrow set of circumstances. Consumer contracts of all kinds routinely exclude liability for consequential damages or impose a low, fixed limit on total liability. Commercial contracts for goods and services ordinarily contain a clause excluding consequential losses, and they also frequently specify liquidated damages in

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79. For additional discussion of these doctrines, see *infra* notes 226-27 and accompanying text.

80. See, e.g., Ayres & Gertner, *supra* note 52, at 1606 (making this claim); Johnston, *supra* note 32, at 621-23 (modeling the *Hadley* rule in strategic terms).

lieu of the default expectation measure. Construction contracts sometimes specify liquidated damages for delay, but they also routinely contain a clause expressly excluding liability for consequential losses. Nevertheless, the question of whether particular losses from breach were foreseeable occasionally arises, and the conventional information-forcing story may well apply to some of these cases.<sup>81</sup> My goal here has been simply to call attention to the surprising frequency of opt-outs and the plausibility of the legal-information-forcing theory as a potential justification for a rule that principally leads sophisticated parties to draft express terms that negate the default rule.

#### *D. Some Additional Examples*

As we have seen, the basic theoretical argument for information-forcing rules extends quite readily to rules designed to encourage parties to disclose legal information. It should perhaps be unsurprising then that courts and legislatures frequently adopt contract default rules for the apparent purpose of dispelling legal ignorance.

##### *1. Implied Just-Cause Employment Contracts*

Consider first the legal rules that determine the terms governing discharge from employment. Although the default rule in all but one major U.S. jurisdiction is employment at-will,<sup>82</sup> the willingness of courts to enforce implied agreements for just-cause protection strongly encourages employers to contract expressly for an at-will relationship.<sup>83</sup> In fact, many judicial decisions expressly invite employers to contract around courts' liberal construction of employee

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81. *See, e.g.*, *Webco Indus. v. Diamond*, No. 11-CV-774-JHP-FHM, 2012 WL 5995740 (N.D. Okla. Nov. 30, 2012) (discussing the relationship between the contract rule of *Hadley* and tort law conceptions of foreseeability); *Stone v. Chi. Title Ins. Co.*, 624 A.2d 496 (Md. 1993) (involving a long sequence of causes for the promisee's loss); *Sunnyland Farms v. Cent. N.M. Elec. Coop.*, 255 P.3d 324 (N.M. Ct. App. 2011), *aff'd in part, rev'd in part*, 301 P.3d 387 (N.M. 2013) (discussing foreseeability of contract damages resulting from a fire); *Kenford Co. v. County of Erie*, 108 A.D.2d 132, 489 (N.Y. App. Div. 1985) (involving a damage claim for a decline in value of adjoining land and loss of profits from developing that land).

82. *See Verkerke, supra* note 14, at 846.

83. *See id.* at 867-68.

handbooks and other informal assurances.<sup>84</sup> Moreover, most courts appear willing, even eager, to enforce express at-will terms so long as they are phrased clearly and positioned prominently among the documents presented to new employees at the time of hiring.<sup>85</sup> These doctrines thus share the first characteristic of legal-information-forcing rules—they are default rules subject to opt-out.

These doctrines satisfy the second criterion as well. Empirical evidence of employment contract practices confirms that an overwhelming majority of legally sophisticated parties contract expressly for an at-will relationship. Most employers, and especially larger, more sophisticated firms, use written confirmations of at-will status.<sup>86</sup> Because the prevailing default rule is employment at will, these express terms are formally superfluous. Nevertheless, such provisions have practical value because they tend to inoculate employers against implied contract claims. A written confirmation of at-will status ordinarily defeats a worker's argument that she understood her employer's written or oral statements to imply a commitment to provide just-cause protection.<sup>87</sup> Employers commonly combine an at-will confirmation with additional terms that bar oral modification and specify that only specific corporate officers have authority to modify the contract. These provisions opt out of two other default rules—specifically the enforcement of oral agreements and the agency doctrine of apparent authority—and provide additional protection against implied contract claims.<sup>88</sup>

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84. See, e.g., *Toussaint v. Blue Cross & Blue Shield*, 292 N.W.2d 880 (Mich. 1980) (finding that a for-cause provision may become part of the contract if the employer's policy statements supported the employee's legitimate expectation of such a provision); *Woolley v. Hoffman La-Roche, Inc.*, 491 A.2d 1257, *modified*, 499 A.2d 515 (N.J. 1985) (finding that termination provisions in an employment manual were sufficient to support a fired employee's claim of an implied contract requiring good cause for discharge).

85. See, e.g., *Guz v. Bechtel Nat'l, Inc.*, 8 P.3d 1089, 1103 (Cal. 2000) (“[The] express disclaimer, reinforced by the statutory presumption of at-will employment, satisfied [employer/defendant's] initial burden, if any, to show that [employee/plaintiff's] claim of a contract limiting [employer/defendant's] termination rights had no merit.”).

86. See Verkerke, *supra* note 14, at 868.

87. *Id.* at 847.

88. See RESTATEMENT (SECOND) OF CONTRACTS § 4 (1981) (“A promise may be stated in words either oral or written, or may be inferred wholly or partly from conduct.”); RESTATEMENT (THIRD) OF AGENCY § 3.03 (2006) (“Apparent authority, as defined in § 2.03, is created by a person's manifestation that another has authority to act with legal consequences for the person who makes the manifestation, when a third party reasonably believes the actor

Implied contract doctrine thus serves a legal-information-forcing function in the employment setting. Courts reason that employers should be bound to a just-cause contract whenever informal assurances or company policies concerning job security would lead a reasonable employee to believe that he had legal protection against arbitrary discharge.<sup>89</sup> Just as readily, however, those same courts enforce formal disclaimers and confirmations of at-will status contained in employee handbooks and on separate forms signed at hiring.<sup>90</sup> Judges assert that any reasonable employees who have

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to be authorized and the belief is traceable to the manifestation.”).

89. *See, e.g.*, *Eales v. Tanana Valley Med.-Surgical Grp.*, 663 P.2d 958, 959 (Alaska 1983) (holding that discharge without cause breached the employment contract when the employer represented to an employee that “so long as he was properly performing his duties he would not be discharged” until he reached retirement); *Walker v. N. San Diego Cnty. Hosp. Dist.*, 185 Cal. Rptr. 617, 621-22 (Ct. App. 1982) (stating that existence of implied in fact agreement providing for just cause termination is an issue of fact for the jury); *Stark v. Circle K Corp.*, 751 P.2d 162, 166 (Mont. 1988) (holding that an employee who had an objectively reasonable belief that he would only be fired for good cause may state a cause of action for breach of contract); *Woolley*, 491 A.2d 1257 (finding an at-will employee to be protected by a for cause implied promise in employee manual); *Forrester v. Parker*, 606 P.2d 191, 192 (N.M. 1980) (stating that the conduct between employer and nonprobationary employee constituted an implied employment contract under employer’s personnel policy guide); *Weiner v. McGraw-Hill, Inc.*, 443 N.E.2d 441 (N.Y. 1982) (holding that an at-will employee pleaded a good cause of action for breach of contract where he was discharged without just cause despite protective provisions in the employee handbook and alleged promises to employee).

90. *See, e.g.*, *Reid v. Sears Roebuck & Co.*, 790 F.2d 453, 456 (6th Cir. 1986) (considering an employment application that included the statement: “In consideration of my employment, I agree [that my] ... employment and compensation can be terminated with or without cause, and with or without notice, at any time, at the option of either the Company or myself”); *Gianaculas v. Trans World Airlines*, 761 F.2d 1391, 1393 (9th Cir. 1985) (considering an employment application that contained the condition: “If given employment, I hereby agree that such employment may be terminated by the company at any time without advance notice and without liability to me for wages or salary”); *Davis v. Lumacorp, Inc.*, 992 F. Supp. 1250 (D. Kan. 1998) (holding that an implied employment contract claim failed when a manager signed an employment application containing a provision that employment was for no definite period of time and could be terminated at any time without prior notice and with or without cause); *Chambers v. Valley Nat’l Bank of Ariz.*, 721 F. Supp. 1128, 1132 (D. Ariz. 1988); *Guz v. Bechtel Nat’l, Inc.*, 8 P.3d 1089, 1103 (Cal. 2000); *Arnold v. Diet Ctr., Inc.*, 746 P.2d 1040, 1041 n.1 (Idaho Ct. App. 1987) (enforcing as a matter of law a disclaimer that stated: “This handbook is not an employment contract, and an employee can be terminated at any time”); *Castiglione v. Johns Hopkins Hosp.*, 517 A.2d 786, 788 (Md. Ct. Spec. App. 1986) (enforcing on motion for summary judgment a disclaimer that stated: “[T]his handbook does not constitute an express or implied contract. The employee may separate from his/her employment at any time; the Hospital reserves the right to do the same”); *Ryan v. Dan’s Food Stores, Inc.*, 972 P.2d 395 (Utah 1998) (holding that a pharmacist’s receipt and acknowledgment of a handbook, which notified him of his at-will status, revoked any express or

read or signed such statements must now understand their unprotected legal status.<sup>91</sup> By opting out of the implied contract doctrine, employers have thus provided what courts evidently consider valuable legal information.<sup>92</sup> Workers exposed to these disclaimers presumably learn the true nature of the legal terms governing discharge from employment.

Finally, notice that both the implied contract doctrine and the *Hadley* rule generate express exculpatory contract terms because sophisticated parties believe that an ostensibly favorable doctrine is insufficiently protective. We have already seen that carriers (and most other suppliers of consumer products and services) worry that the foreseeability standard is too generous and too vague.<sup>93</sup> Likewise, employers have no confidence that the at-will default will protect them from unjust discharge claims.<sup>94</sup> Modern erosions of the traditional employment-at-will doctrine invite litigation and encourage employers to confirm workers' at-will status just as uncertainty about foreseeability drives carriers to contract expressly for a more protective damage rule.<sup>95</sup>

## 2. ERISA Rules

Case law under the Employee Retirement Income Security Act (ERISA) similarly includes numerous instances in which a plan sponsor must include specific contract language in order to avoid an unfavorable construction of its benefit plan. The Supreme Court's decision in *Firestone Tire & Rubber v. Bruch*, for example, attached talismanic significance to highly specific terms found in the formal

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implied contractual conditions contradictory to the handbook).

91. *E.g.*, *Rowe v. Montgomery Ward & Co.*, 473 N.W.2d 268, 275 (Mich. 1991) (“[The signed ‘Rules of Personal Conduct’ sheet] did not contain elaborate disciplinary procedures and, more importantly, did not contain the ‘release for just cause only’ language.... Plaintiff’s agreement to abide by those rules suggests that any subjective belief she maintained that she could only be dismissed for failure to obtain her quota was not reasonable.”).

92. *Id.*

93. *See supra* Part I.C.

94. *See Verkerke, supra* note 14, at 839 (“[A] series of doctrinal innovations ... has left the at will rule significantly eroded.”).

95. Merger clauses that contract for a fully integrated agreement may serve a very similar purpose. *See, e.g.*, Albert Choi, *The Parol Evidence Rule, Information Disclosure, and the Value of an Oral Promise* 11 (Univ. of Va. L. & Econ. Research Paper Series, Paper No. 17, 2009), available at <http://perma.cc/L8QH-MKKG>.

plan.<sup>96</sup> The Court opined that if, and only if, the employer includes language giving the plan administrator discretionary authority to interpret and construe the terms of the plan, then the administrator's decisions to deny benefits will be reviewed using a deferential "arbitrary and capricious" standard.<sup>97</sup> If the magical language is not present, however, courts are to conduct a *de novo* review of all benefit denials.<sup>98</sup> Predictably, all well-counseled employers have responded to this ruling by amending their benefit plans to include the necessary terms.<sup>99</sup>

The Court's opinion in *Firestone* never specifically invoked an information-forcing rationale for its rule.<sup>100</sup> Instead, Justice O'Connor applied formal doctrinal rules from the law of trusts.<sup>101</sup> Although this doctrinal analysis has been subject to withering criticism,<sup>102</sup> an alternative justification for the Court's ruling is that plan participants and beneficiaries should have some way of knowing what standard of review will apply to their disputes with plan administrators. The specific language required by *Firestone* thus might alert individuals that their plan administrator has significant discretion over benefit payments. The Court's decision establishing *de novo* review as the default rule clearly permits opt-outs, and virtually every plan now expressly grants the administrator discretionary authority to interpret and construe the terms of the plan.<sup>103</sup> In

96. 489 U.S. 101, 112 (1989).

97. *Id.* at 102.

98. *Id.* at 115 ("Consistent with established principles of trust law, we hold that a denial of benefits challenged under § 1132(a)(1)(B) is to be reviewed under a *de novo* standard unless the benefit plan gives the administrator or fiduciary discretionary authority to determine eligibility for benefits or to construe the terms of the plan.").

99. See, e.g., John H. Langbein, *The Supreme Court Flunks Trusts*, 1990 SUP. CT. REV. 207, 220 ("The Court's emphasis in *Bruch* on the trust instrument as the basis for deferential review raises the prospect that an ERISA plan may opt out of *Bruch's* *de novo* review and back into the pre-*Bruch* world of judicial deference merely by inserting some boilerplate to that effect in the plan instrument.").

100. Justice O'Connor explained: "In determining the appropriate standard of review for actions under § 1132(a)(1)(B), we are guided by principles of trust law." 489 U.S. at 111 (citing *Cent. States, Se. & Sw. Areas Pension Fund v. Cent. Transp., Inc.*, 472 U.S. 559, 570 (1985)).

101. *Id.*

102. See, e.g., Langbein, *supra* note 99, at 218.

103. See, e.g., Beverly Cohen, *Divided Loyalties: How the Metlife v. Glenn Standard Discounts ERISA Fiduciaries' Conflicts of Interest*, 2009 UTAH L. REV. 955, 960 ("Ultimately, pronouncement of the *Firestone* standard of review resulted in the amendment of virtually all ERISA plans to confer discretion on fiduciaries to construe or interpret the terms of their

functional terms, the *Firestone* approach thus establishes a paradigmatic legal-information-forcing rule.

Other ERISA rules reveal a similar pattern. In some circuits at least, a default rule restricts a plan sponsor's right to make unilateral changes to the terms of the plan.<sup>104</sup> However, plans routinely include express language permitting amendment or termination of the plan.<sup>105</sup> The default rule thus has no practical effect other than inducing plan sponsors to provide information about the legal rule governing plan modifications.

At a more pedestrian level, lower court cases interpreting ERISA's requirement of a summary plan description (SPD) impose several contradictory standards that are curiously unified by their confident reliance on the informative value of express contract terms. Cases falling at one end of the spectrum require employers to include in the SPD extremely specific legal facts concerning the circumstances that might lead to a benefit denial.<sup>106</sup> Employers who fail to provide this legal information risk having to pay participants benefits to which they would not be entitled under the terms of the formal plan. In contrast, other cases give employers much wider latitude to omit information from the SPD so long as the SPD includes an express disclaimer directing beneficiaries to consult the formal plan

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plans. By so doing, employers secured for themselves under the *Firestone* standard the substantial benefit of receiving deferential rather than de novo review when plan members challenged benefit denials." (citation omitted)); John H. Langbein, *Trust as Regulatory Law: The UNUM/Provident Scandal and Judicial Review of Benefit Denials Under ERISA*, 101 NW. U. L. REV. 1315, 1324 (2007) ("ERISA plans are virtually always professionally drafted instruments, the work of specialist counsel or plan administration firms. Plan drafters routinely seize upon *Bruch's* invitation to instruct the courts to defer to plan decisionmaking. In consequence, deferential review pervades the ERISA-plan world, despite the primary holding in *Bruch* that purports to establish the opposite." (citation omitted)); Paul M. Secunda, *Cultural Cognition Insights into Judicial Decisionmaking in Employee Benefits Cases*, 3 AM. U. LAB. & EMP. L.F. 1, 13 n.73 (2013) ("Unsurprisingly, the *Firestone* decision has led most employers to design plans with language investing its plan administrators with the necessary discretionary authority in order to take advantage of the more favorable review standard." (citing COLLEEN E. MEDILL, INTRODUCTION TO EMPLOYEE BENEFITS LAW: POLICY AND PRACTICE 532 (3d ed. 2011))).

104. See, e.g., *Rossetto v. Pabst Brewing Co.*, 217 F.3d 539, 543-44 (7th Cir. 2000).

105. See, e.g., *Sprague v. Gen. Motors Corp.*, 133 F.3d 388 (6th Cir. 1998) (en banc) (enforcing plan sponsor's express right to modify contained in the formal plan despite seemingly contradictory language in many plan summaries).

106. See, e.g., *Ruotolo v. Sherwin-Williams Co.*, 622 F. Supp. 546, 549 (D. Conn. 1985); *Zittrouer v. Uarco Inc. Grp. Benefit Plan*, 582 F. Supp. 1471, 1474 (N.D. Ga. 1984).

documents to determine their rights and obligations.<sup>107</sup> Under both approaches, the default rule formally favors employees but seems designed solely to induce employers to include certain legal information in their SPD. As with the *Firestone* rule, the universal practice of plan sponsors is to opt out of the default by providing the required information.

### 3. Other Disclaimers, Waivers, and Limitations of Liability

Legal-information-forcing rules are equally common outside of the employment context. We have already seen how the *Hadley* rule “forces” carriers and other commercial parties to include liability limitations in their contracts.<sup>108</sup> Many other providers of products and services employ a similar strategy of disclaimer and liability limitation. Recall, for example, your last skydiving or hang-gliding lesson. Or think about the documents you signed before participating in a whitewater rafting adventure or when you registered your child to play youth soccer, lacrosse, or football. In each of these cases, the activity sponsor faces potential tort liability for any negligently caused injuries to participants. However, courts routinely give effect to prospective waivers of liability for ordinary negligence.<sup>109</sup> The barrage of exculpatory clauses that greet participants in these activities is the predictable consequence of these rules. The ubiquity and enforceability of these waivers transforms at least part of the ostensibly mandatory tort rule into a legal-information-forcing default.

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107. See, e.g., *Kolentus v. Avco Corp.*, 798 F.2d 949, 958 (7th Cir. 1986).

108. See *supra* Part I.C.

109. A few states refuse to enforce prospective waivers of negligence liability. See, e.g., *Hiatt v. Lake Barcroft Cmty. Ass'n*, 418 S.E.2d 894, 897 (Va. 1992) (relying on the court's prior decision in *Johnson's Adm'x v. Richmond & Danville R.R.*, 11 S.E. 829 (Va. 1890)). In many jurisdictions, however, prospective waivers ordinarily protect against liability for negligence but remain ineffective against claims based on reckless or intentional conduct. See RESTATEMENT (SECOND) OF CONTRACTS § 195 (1981) (“(1) A term exempting a party from tort liability for harm caused intentionally or recklessly is unenforceable on grounds of public policy. (2) A term exempting a party from tort liability for harm caused negligently is unenforceable on grounds of public policy [in several narrowly defined circumstances].”). *But see* RESTATEMENT (THIRD) OF TORTS § 2 (2000) (suggesting that prospective waivers may also be enforceable for claims based on a defendant's reckless or intentional conduct).



Similarly, the Uniform Commercial Code contemplates—and product manufacturers routinely invoke—an express formula for disclaiming the Code’s default warranty of merchantability and limiting consequential damages.<sup>110</sup> Credit card agreements always include a variety of exculpatory clauses designed to protect the credit card issuer from liability for refusing to authorize a particular credit transaction.<sup>111</sup> Contracts for services such as car rental agreements contain a host of clauses that place responsibility for certain losses on the rental customer and excuse the rental company from liability.<sup>112</sup> Computer software end-user license agreements (EULAs) uniformly include comprehensive disclaimers of virtually every form of liability that might be imposed on the software publisher and strictly limit the purchaser to the remedy of replacing defective disks.<sup>113</sup> Software downloaded from the Web similarly requires prior consent to a “click-wrap” license that contains a familiar litany of exculpatory clauses.<sup>114</sup> Finally, online communities

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110. See U.C.C. § 2-316(2) (2012) (“[T]o exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify any implied warranty of fitness the exclusion must be by a writing and conspicuous.”). Revised Article 2 carries forward a similar, though even more specific formula: “[T]o exclude or modify the implied warranty of merchantability or any part of it in a consumer contract the language must be in a record, be conspicuous, and state ‘The seller undertakes no responsibility for the quality of the goods except as otherwise provided in this contract,’ and in any other contract the language must mention merchantability and in case of a record must be conspicuous.” U.C.C. § 2-316(2) (Proposed Official Draft 2003). Similarly, U.C.C. § 2-719(3) provides that: “Consequential damages may be limited or excluded unless the limitation or exclusion is unconscionable.”

111. See, e.g., *Capital One Customer Agreement*, CAP. ONE FIN. CO. 3 (July 16, 2013), [http://files.consumerfinance.gov/a/assets/credit-card-agreements/pdf/creditcardagreement\\_8794.pdf](http://files.consumerfinance.gov/a/assets/credit-card-agreements/pdf/creditcardagreement_8794.pdf) [<http://perma.cc/3LUJ-L3P6>] (“We are not responsible if anyone refuses to accept your *Card* for any reason. Also, we may reject any transaction for any reason.”).

112. See, e.g., *Dollar Rent A Car General Policies*, DOLLAR RENT A CAR (Feb. 9, 2012), <http://www.dollar.com/AboutUs/GeneralPolicies.aspx> [<http://perma.cc/3BP4-JZXE>] (last visited Feb. 3, 2015) (excluding liability and offering optional insurance coverage).

113. See, e.g., *Adobe End-User License Agreement*, ADOBE SYS. INC., <https://www.adobe.com/support/downloads/license.html> [<http://perma.cc/EB9N-LR25>] (last visited Feb. 3, 2015) (“Limit of Liability: In no event will Adobe be liable to you for any loss of use, interruption of business, or any direct, indirect, special, incidental, or consequential damages of any kind (including lost profits) regardless of the form of action whether in contract, tort (including negligence), strict product liability or otherwise, even if Adobe has been advised of the possibility of such damages.”).

114. See, e.g., *Software License Agreement for iTunes*, APPLE INC. 4-5 (Sept. 10, 2013), <http://images.apple.com/legal/sla/docs/iTunesForWindows.pdf> [<http://perma.cc/8FVN-VKCM>] (last visited Feb. 3, 2015). For unusually insightful empirically based analysis of click-wrap

and web-based services demand that participants agree to an exhaustive list of liability limitations and service restrictions.<sup>115</sup>

The common thread that runs through all of these examples is that sophisticated contracting parties respond to legal rules favoring their contractual partners by adopting express terms that shift the balance of legal rights in their own favor. Traditional majoritarian default rule analysis would criticize these doctrines for generating unnecessary transaction costs.<sup>116</sup> On this view, the rules cause wasteful efforts to draft disclaimers, liability limitations, and other exculpatory clauses that appear in virtually every contract.<sup>117</sup> The theory of legal-information-forcing defaults provides an alternative, potentially more constructive role for these doctrines.<sup>118</sup> According to this perspective, the routine practice of contracting around such rules conveys valuable legal information to comparatively unsophisticated parties.<sup>119</sup> It remains to be seen, however, whether express contract terms successfully dispel our widespread legal ignorance.

## II. THE PROBLEM WITH A LEGAL-INFORMATION-FORCING JUSTIFICATION

In this Part, I identify a significant practical problem with legal-information-forcing rules. As a result, legal ignorance persists even in the face of fully informative express contract terms.<sup>120</sup> Scholars, and to a lesser extent judges, have sometimes considered this problem, but their analysis does little to clarify the appropriate

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licenses and EULAs, see Florencia Marotta-Wurgler, *Are "Pay Now, Terms Later" Contracts Worse for Buyers? Evidence from Software License Agreements*, 38 J. LEGAL STUD. 309, 311 (2009); Florencia Marotta-Wurgler, *Competition and the Quality of Standard Form Contracts: The Case of Software License Agreements*, 5 J. EMPIRICAL LEGAL STUD. 447, 449-50 (2008); Florencia Marotta-Wurgler, *What's in a Standard Form Contract? An Empirical Analysis of Software License Agreements*, 4 J. EMPIRICAL LEGAL STUD. 677, 678-79 (2007). A recent book by Nancy Kim has also focused critical attention on click-wrap and browse-wrap license agreements. KIM, *supra* note 19.

115. See *Facebook Statement of Rights and Responsibilities*, FACEBOOK, <http://www.facebook.com/terms.php> [<http://perma.cc/3Z65-JMCH>] (last visited Jan. 25, 2015) (containing a comprehensive disclaimer in § 63).

116. Ayres & Gertner, *supra* note 52, at 1592.

117. *Id.*

118. See *supra* Part I.A.

119. *Id.*

120. See *supra* notes 2, 56.

scope or design of these default rules.<sup>121</sup> One possible response to the shortcomings of legal-information-forcing defaults would be to develop more effective ways to convey legal information to unsophisticated parties. I argue, however, that we currently lack essential empirical facts about how people obtain and process legal information. Moreover, many parties are rationally ignorant about contract terms and efforts to make them fully informed would be socially wasteful.

#### *A. The Persistence of Legal Ignorance*

As the previous Part demonstrated, contract documents that we encounter in our everyday lives as consumers and employees include an extraordinary quantity of legal information. In light of the ubiquity of express contract terms, it is nothing short of remarkable how little we seem to know about the law governing our diverse transactions.<sup>122</sup> But a moment's reflection reveals a straightforward explanation for this divergence between the quantity of information provided and the level of legal understanding achieved. A major premise underlying the argument for legal-information-forcing rules is almost certainly false. To put the matter most simply: people quite often ignore the text of written contracts.

Almost no one reads contracts carefully enough to digest the legal information that these default rules are designed to force.<sup>123</sup> Indeed, the ostensible audience for this legal information—consumers, employees, and other comparatively unsophisticated parties—is the least likely to invest sufficient time and attention to benefit from the newly available contractual terms. Thus, if the purpose of these default rules is to convey legal information to all, or even many, unsophisticated parties, the default rules likely frustrate that objective.

In response to this problem, courts have developed some doctrinal requirements designed to ensure that parties understand their contractual undertakings.<sup>124</sup> Commentators and legislators have

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121. *See infra* Part II.B.1.

122. *See supra* notes 2, 56.

123. *See* Ben-Shahar & Schneider, *supra* note 3, at 651; Bakos et al., *supra* note 19, at 4.

124. *See infra* notes 155-58 and accompanying text.

focused their attention on mandatory disclosure regulations.<sup>125</sup> The next Section discusses these efforts and explains how they differ from and relate to legal-information-forcing default rules.

### *B. Judicial and Scholarly Perspectives on Legal Ignorance*

Several strands of the scholarly literature bear some relation to the problems we have been considering.

#### *1. Disclosure Requirements*

First, a substantial body of work explores the potential benefits of imposing legal disclosure requirements in various transactional settings. For example, federal law requires lenders to disclose repayment terms and annual percentage rates in a standardized format.<sup>126</sup> Similarly, food and drug law requires product labels to include ingredient lists and nutritional information.<sup>127</sup> And federal securities law mandates that issuers publish a comprehensive prospectus describing any new offering in excruciating detail.<sup>128</sup>

Considerable effort has gone into evaluating the success or failure of particular disclosure obligations. An early article by William Whitford, for example, reviewed studies of how truth-in-lending laws affect consumer knowledge of credit terms.<sup>129</sup> More recently, commentators have argued that excessive disclosure requirements create a danger of information overload.<sup>130</sup> Still other work relies on experimental studies of consumer behavior to challenge the information-overload hypothesis.<sup>131</sup> These papers show that consumer search strategies readily adapt to the presence of too much

125. See *infra* notes 126-37 and accompanying text.

126. See 15 U.S.C. § 1601 (2012) (Truth in Lending statements required by FTC Act).

127. See 21 C.F.R. § 101.1 (2014) (FDA disclosure regulations).

128. See 12 C.F.R. § 16.3 (2014) (SEC disclosure regulations).

129. See generally William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WIS. L. REV. 400.

130. See Naresh K. Malhotra, *Information Load and Consumer Decision Making*, 8 J. CONSUMER RES. 419 (1982); Naresh K. Malhotra, *Reflections on the Information Overload Paradigm in Consumer Decision Making*, 10 J. CONSUMER RES. 436, 437 (1984).

131. David M. Grether et al., *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277, 279-80 (1986).

information by simply ignoring the excess.<sup>132</sup> As a result, excessive disclosure may well be worthless, but it does not cause consumers to make poor choices as a result of an “overload” of information.<sup>133</sup>

In a recent book, Omri Ben-Shahar and Carl Schneider expand their prior critique of mandatory disclosure regulations.<sup>134</sup> They argue that most people have little taste for reading mandated disclosures.<sup>135</sup> Consumers ignore the flood of information contained in boilerplate terms and instead make decisions on the basis of simpler rules of thumb. Ben-Shahar and Schneider observe that disclosure regulations particularly appeal to legislators because, as compared to more intrusive substantive rules specifying permissible contract terms, mere disclosure requirements appear to impose far less intrusive obligations on businesses.<sup>136</sup> Moreover, designing mandatory rules for consumer transactions requires much more empirical information and necessarily runs the risk of causing unintended effects on the supply of goods and services. They conclude that the current regulatory strategy produces far more harm than good.<sup>137</sup> In their view, the current disclosure regime should be abandoned and replaced with more direct consumer protection measures when sufficient evidence warrants intervention.<sup>138</sup>

The disclosure literature undoubtedly sheds light on consumers’ information-processing techniques. Skeptical scholarly assessments of mandatory disclosure regulations also tend to confirm our conjecture that unsophisticated parties derive little or no benefit from the boilerplate language that legal-information-forcing rules inspire.<sup>139</sup> However, disclosure regulations and legal-information-forcing defaults differ in important respects. The sanction for violating disclosure rules is typically a civil or criminal penalty of some kind.<sup>140</sup> In contrast, a party who fails to provide the information targeted by

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132. *Id.* at 284-85.

133. *Id.* at 301.

134. BEN-SHAHAR & SCHNEIDER, *supra* note 3, at 3-4.

135. *Id.* at 10-11.

136. *Id.* at 5-6.

137. *Id.* at 12.

138. *Id.* at 12-13.

139. *Id.* at 8-11.

140. *See* Whitford, *supra* note 129, at 432-33.

an information-forcing default must carry out the transaction under an unfavorable legal rule. The most appropriate remedy for excessive disclosure regulations is simply to eliminate the unproductive legal requirements. Fixing a malfunctioning legal-information-forcing default, in contrast, requires a lawmaker to determine an appropriate legal rule to govern the transaction in question. Moreover, disclosure regulations typically specify with great precision what information parties must disclose, and how they must make these required disclosures. Information-forcing defaults are ordinarily cast in more general terms and leave the details of contract drafting to the discretion of the disclosing party.<sup>141</sup> This lack of standardization significantly complicates the task of evaluating the effectiveness of a legal-information-forcing default rule.

## 2. Boilerplate and Contracts of Adhesion

One salient fact about legal-information-forcing rules is that the targeted information is most often communicated in a standardized form contract, such as a bill of sale, an employee handbook, a standard form insurance contract, a release of liability, or a rental agreement.<sup>142</sup> Another important strand of contracts scholarship examines the problems associated with enforcing such standard form agreements, which are typically offered on a take-it-or-leave-it basis. Often referred to as contracts of adhesion, these form contracts have been the subject of frequent academic criticism.<sup>143</sup>

In a widely discussed recent book, Margaret Jane Radin has launched a wide-ranging critique of contemporary consumer contract practices.<sup>144</sup> She documents the ubiquity of fine-print terms in

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141. For examples of employment contract disclaimers and confirmations of at-will status, see *supra* notes 84-85.

142. RADIN, *supra* note 19, at 9-11.

143. See, e.g., Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 632-33 (1943); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1175-76 (1983).

144. RADIN, *supra* note 19, at 16-18. For commentary on the book, see Omri Ben-Shahar, *Regulation Through Boilerplate: An Apologia*, 112 MICH. L. REV. 883 (2014) (reviewing RADIN, *supra* note 19), to which Radin has responded. Margaret Jane Radin, *What Boilerplate Said: A Response to Omri Ben-Shahar (and a Diagnosis)* (Univ. of Mich. Pub. Law Research Paper Series, Paper No. 392, Univ. Mich. Law & Economics Research Paper Series, Paper No. 14-

consumer transactions that limit liability, restrict remedies, and impose mandatory arbitration. Focusing first on the question of consent, Radin rejects arguments that consumers impliedly agree to these terms.<sup>145</sup> Mere awareness that such terms are likely to be a part of any transaction cannot substitute for the manifestation of mutual assent at the core of traditional contract doctrine. Nor is it sufficient to argue that boilerplate terms economize on transaction costs or promote efficient risk allocations. Radin indicts lawmakers for their inattention to these problems and contends the routine enforcement of boilerplate ultimately undermines the rule of law.<sup>146</sup> She proposes various regulatory measures to control these private efforts to supplant legal obligations. Courts should scrutinize these “rights deletions” closely and, she contends, refuse to enforce terms that interfere with important public values.<sup>147</sup> Indeed, Radin suggests that the most egregious efforts to impose one-sided terms through boilerplate should subject the drafters to potential tort liability.<sup>148</sup>

In contrast, many legal economists have defended contemporary contract practices. According to this competing account, legal ignorance is widespread, but economic efficiency compels mass-market sellers and service providers to develop standardized terms and rely on streamlined methods of obtaining consumer consent to those terms.<sup>149</sup> Individual negotiations with consumers are infeasible and would be wasteful. Instead, we can rely on competitive pressure and a small minority of comparison shoppers to police contract terms.<sup>150</sup> An unusually nuanced version of this efficiency argument proposes that business firms use standard-form contracts

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007, Feb. 2014), available at <http://perma.cc/WRZ9-Z7PP>. And for a rich selection of scholarly perspectives on the broader topic of boilerplate terms, see Omri Ben-Shahar, *Foreword*, 104 MICH. L. REV. 821 (2006).

145. RADIN, *supra* note 19, at 13-14.

146. Margaret Jane Radin, *Boilerplate: A Threat to the Rule of Law?*, in PRIVATE LAW AND THE RULE OF LAW (Lisa M. Austin & Dennis Klimchuk eds., 2014).

147. RADIN, *supra* note 19, at 246-47.

148. *Id.* For another recent critique of modern consumer contract practice, see KIM, *supra* note 19.

149. See, e.g., Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, 104 MICH. L. REV. 827, 827-28 (2006); 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, 858 (2006).

150. See Schwartz & Wilde, *supra* note 6, at 638.

to establish a restrictive baseline from which they allow their managerial agents to negotiate discretionary exceptions granting benefits to which consumers are not legally entitled.<sup>151</sup>

Judicial reaction to contracts of adhesion has been, for the most part, accepting and accommodating. Although judges express occasional misgivings about enforcing form contracts, courts have largely ignored the most extreme academic critics who would, for example, create a presumption against enforceability.<sup>152</sup> Instead, prevailing law enforces unfavorable form contract terms against unsophisticated parties so long as they meet minimal standards of procedural fairness.<sup>153</sup> Judges appear to assume that adhering parties are either adequately informed about the terms of their agreement or that a competitive market provides sufficient protection against fundamentally unfair agreements.<sup>154</sup> On those few occasions that courts refuse enforcement, they almost invariably find that a particular clause is both substantively oppressive and that the process of agreement was flawed in some way.<sup>155</sup>

No such problems afflict the express terms that are the subject of this Article. Although the terms with which we are concerned almost always appear in form contracts, few if any of them are even arguably unconscionable. Indeed, numerous judicial decisions expressly invite employers or other sophisticated parties to include specific contract language in order to avoid the unfavorable consequences of the legal-information-forcing default rule.<sup>156</sup> It would be utterly incongruous to invite parties to contract around an information-forcing default rule and then hold that the invited terms were unconscionable. Moreover, courts have shown little

151. See Johnston, *supra* note 149, at 858.

152. See Rakoff, *supra* note 19, at 1195.

153. See, e.g., *Cole v. Burns Int'l Sec. Servs.*, 105 F.3d 1465 (D.C. Cir. 1997) (enforcing a contract to arbitrate, but discussing minimal standards of procedural fairness); *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147, 1149 (7th Cir. 1997) (relying on an efficiency analysis to enforce an arbitration clause contained in a buy-now-terms-later purchase contract).

154. See, e.g., *Hunter v. Tex. Instruments*, 798 F.2d 299, 302-03 (8th Cir. 1986); RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 116 (7th ed. 2007) (“[I]f one seller offers unattractive terms ... a competing seller, wanting sales for himself, [will] offer more attractive terms, the process continuing until the terms are optimal.”).

155. See, e.g., *Fitz v. NCR Corp.*, 13 Cal. Rptr. 3d 88, 95 (Cal. Ct. App. 2004) (finding an express arbitration agreement in an employment contract void under California’s unconscionability doctrine).

156. See *supra* note 58 and accompanying text.



sympathy for litigants who claim not to have read or understood provisions of the legal documents they have signed.<sup>157</sup> The “duty to read” doctrine creates a virtually irrebuttable presumption that a person is fully aware of the contents of any writing that he or she has signed.<sup>158</sup> With the exception of cases involving potential fraud or misrepresentation, courts thus stand ready to enforce the express contract terms that legal-information-forcing rules cause sophisticated parties to include in their agreements.

### *3. Academic Support for Legal-Information-Forcing Rules*

Indeed, recent academic commentary lauds the potential utility of legal-information-forcing default rules. My own prior work on employment contract practices first suggested a legal-information-forcing rationale for rules that liberally construe informal assurances of job security against employers.<sup>159</sup> Richard Craswell discussed a similar argument in the context of consumer contracting.<sup>160</sup> Cynthia Estlund has proposed a strong default rule of just cause to ensure that firms will clearly inform their workers about the terms governing discharge.<sup>161</sup> And Cass Sunstein has embraced the legal-information-forcing theory as a general argument for switching default rules to favor employees.<sup>162</sup>

One common characteristic of all existing legal-information-forcing arguments is that they rely on an assumption that the targeted information will be received and understood.<sup>163</sup> Despite the

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157. See, e.g., *Williams v. Windermere Real Estate/East, Inc.*, 138 Wash. App. 1014 (Wash. Ct. App. 2007) (unpublished opinion) (“[Plaintiff] is charged with knowledge of the contents of documents she signs. Parties have a duty to read the contracts they sign.”); *Eder v. Lake Geneva Raceway, Inc.*, 523 N.W.2d 429, 431 (Wis. Ct. App. 1994) (“The failure to read a contract does not by itself affect the contract’s validity.”).

158. For a typical application of this doctrine, see *Reid v. Sears, Roebuck & Co.*, 790 F.2d 453 (6th Cir. 1986).

159. See Verkerke, *supra* note 14, at 874.

160. Richard Craswell, Benjamin E. Hermalin & Avery W. Katz, *Contract Law, in HANDBOOK OF LAW AND ECONOMICS* 87-88 (A. Mitchell Polinsky & Steven Shavell eds., 2007).

161. Estlund, *How Wrong Are Employees*, *supra* note 20, at 7-8.

162. Sunstein, *Human Behavior*, *supra* note 22, at 206; Sunstein, *Switching the Default Rule*, *supra* note 22, at 110.

163. See, e.g., *Woolley v. Hoffmann-La Roche, Inc.*, 491 A.2d 1257, 1264 (N.J. 1985) *modified*, 499 A.2d 515 (N.J. 1985). See generally Verkerke, *supra* note 14; Verkerke, *supra* note 8, at 64-65.

myriad legal-information-forcing default rules currently in effect, however, legal ignorance persists. Existing doctrines cause contracts to include copious quantities of legal information. But neither courts nor commentators appear to have given much thought to the question of whether these express terms serve their ostensible purpose of informing parties about the legal rules governing the transaction.

One possible response to the persistence of legal ignorance would be to improve the quality of existing legal disclosures. Lawmakers might try to design information-forcing rules that induce sophisticated parties to provide legal information in a manner that is more likely to be read and understood. The next section reviews the surprisingly sparse research available on this issue and speculates about the feasibility of perfecting the informative function of information-forcing rules.

### *C. Designing Effective Express Contract Terms*

In light of the prevalence of legal-information-forcing default rules, one would expect to find substantial research investigating how to make those rules most effective. In fact, only a few scholars have produced work that bears directly on this issue.

A worldwide movement to promote the use of plain language in public and private documents explicitly aims to make these legal materials more readable and understandable to a layperson. Beginning in the 1970s, some leading U.S. financial institutions voluntarily rewrote their loan agreements and other consumer contracts.<sup>164</sup> State legislation followed and currently imposes plain language requirements for consumer contracts in a number of jurisdictions.<sup>165</sup> I am unaware, however, of any evidence showing that these otherwise admirable efforts have increased consumers' willingness to read the complex contracts they sign. Indeed, the apparent futility of even more intrusive and demanding disclosure regulations suggests that most consumers see no compelling reason

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164. See Debra R. Cohen, *Competent Legal Writing—A Lawyer's Professional Responsibility*, 67 U. CIN. L. REV. 491, 500-01 (1999).

165. See *supra* note 21.

to spend the time required to read and understand these documents.<sup>166</sup>

In the more specific context of employment contracting, Pauline Kim has found that workers significantly overestimate the extent of their legal protection against unjust discharge.<sup>167</sup> Her study also investigated whether commonly used confirmations of at-will status would ameliorate this biased assessment of prevailing law. Her principal finding on this question was that these contractual disclaimers had no measurable effect on respondents' assessment of hypothetical discharge scenarios.<sup>168</sup> They continued to express overly optimistic beliefs about the law governing employment termination. As Kim acknowledged, her survey respondents may have failed to distinguish between informal workplace norms and legally enforceable obligations.<sup>169</sup> And the survey design involved asking subjects about specific termination scenarios before introducing the at-will language and then asking the same subjects about the same scenarios.<sup>170</sup> Thus, a conditioning effect could explain why subjects offered the same responses in the treatment condition. A better experimental design would separate treatment and control groups to determine the effect of at-will language on subjects' beliefs about job security. Nevertheless, Kim's study provides at least suggestive evidence that individuals' beliefs about job security may be unchanged by commonly used employment contract practices.

More recent work by Jesse Rudy improved on Kim's study by surveying employed individuals rather than those who had recently lost their jobs.<sup>171</sup> Rudy confirmed Kim's findings about workers' tendency to overestimate the legal protections against discharge

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166. See BEN-SHAHAR & SCHNEIDER, *supra* note 3; Bakos et al., *supra* note 19.

167. Pauline T. Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105, 133 (1997).

168. *Id.* at 139-40.

169. For further discussion of just-cause norms in the workplace, see Pauline Kim, *Norms, Learning and Law: Exploring the Influences on Workers' Legal Knowledge*, 1999 U. ILL. L. REV. 447; Edward B. Rock & Michael L. Wachter, *The Enforceability of Norms and the Employment Relationship*, 144 U. PA. L. REV. 1913, 1916-17 (1996).

170. Kim, *supra* note 167, at 110.

171. Jesse Rudy, *What They Don't Know Won't Hurt Them: Defending Employment-At-Will in Light of Findings that Employees Believe They Possess Just Cause Protection*, 23 BERKELEY J. EMP. & LAB. L. 307, 311 (2002).

that they enjoy.<sup>172</sup> Because he chose to administer a survey instrument identical to the one Kim employed, however, his replication of her results showing the ineffectiveness of at-will language is subject to the same methodological criticism. Despite these reservations, the results of these studies remain the most direct demonstration that legal-information-forcing rules concerning employment termination may fail to inform workers about the law.

What then might explain why workers would remain oblivious to their legal status despite prominent contractual language that, at least nominally, informs them of their rights? In this context at least, there are strong reasons to believe that workers are rationally ignorant about the legal terms governing employment termination.<sup>173</sup> Viewed at the time of contracting, practical obstacles that stand in the way of vindicating a worker's contractual right against unjust termination diminish the value of that right. For example, many discharged workers will be unable to obtain legal counsel, or afford the cost of legal representation. This lack of representation will likely deter them from challenging their termination. Moreover, evidence to rebut an employer's asserted reason for discharge may often be unavailable. Faced with the prospect of spending several unpleasant years embroiled in litigation with an uncertain outcome, many terminated workers will choose instead to focus on finding a new job.

Other sources of both legal and extra-legal protection against unjust termination further diminish the marginal value of contractual rights. Employment discrimination statutes, whistleblowing laws, the tort of wrongful discharge in violation of public policy, and a wide variety of anti-retaliation provisions in state and federal statutes offer considerable non-waivable legal protection against being discharged for a bad reason. Most workers also enjoy some extra-legal assurance against unjust termination because an informal just-cause norm prevails in the majority of U.S. workplaces.<sup>174</sup> In short, workers may rationally conclude that the cost of becoming

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172. *Id.*

173. Rudy, *supra* note 171, at 359; J.H. Verkerke, *Employment Contract Law*, in *THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW* 47, 52 (1998).

174. See Rock & Wachter, *supra* note 169, at 1917.

better informed about contractual terms governing discharge exceeds any expected benefit that such knowledge could confer.

One potential solution to the problem of rational ignorance about contract terms would be to target legal-information-forcing efforts on specific terms that unsophisticated parties would benefit from knowing. In a recently published article, Ian Ayres and Alan Schwartz describe a novel solution to the “no-reading problem” that afflicts consumer contracting.<sup>175</sup> Their approach begins with the familiar empirical observation that consumers have little interest in reading the standard form contracts they sign.<sup>176</sup> The venerable duty-to-read doctrine therefore rests on a counterfactual presumption about consumer behavior. Ayres and Schwartz observe, however, that consumers need not read to learn about prevailing contract terms. Instead, they form expectations about terms based on what they learn from store visits, read in the media, experience in their own transactions, and hear from friends.<sup>177</sup> These beliefs may accurately correspond to the content of a particular contract. Or consumers may suffer from “term optimism,” a mistaken belief that a contract’s terms are more favorable than the provisions actually included in its text.<sup>178</sup>

Ayres and Schwartz propose an elaborate contracting regime designed to combat term optimism. Their system would induce mass-market sellers to survey consumers periodically to determine if those consumers correctly understood the terms of the sellers’ agreements, a process they call “term substantiation.”<sup>179</sup> Sellers then would be required to use a standardized warning box to disclose any terms that consumers mistakenly thought were more favorable.<sup>180</sup> In addition, sellers would have to conduct follow-up surveys to demonstrate that these warnings were effective.<sup>181</sup>

This proposal wisely recognizes that consumers have multiple sources of information about contract terms. The system of term

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

176. *See id.* at 545.

177. *See id.* at 550-51.

178. *See id.* at 551-52.

179. *Id.* at 552-53.

180. *See id.* at 553.

181. *See id.* at 584.

substantiation and standardized warnings also cleverly limits disclosure efforts in an effort to make them more effective. The standardized warning box would include only those terms about which consumers are overly optimistic, and would exclude any terms a majority of consumers regard as insignificant. As Ayres and Schwartz demonstrate, sellers already have an adequate incentive to correct consumers' mistakenly pessimistic beliefs about contract terms.<sup>182</sup> Moreover, they speculate that typographic standardization and careful targeting of the information in the warning box will encourage consumers to pay attention.<sup>183</sup>

Although this creative attempt to make contract terms truly informative is admirable, its prospects for adoption seem remote at best.<sup>184</sup> Perhaps there exists no feasible method of communicating contract terms that would inform unsophisticated parties about the legal rules governing their transactions. If this speculation is correct, we must entertain the possibility that for some legal rules the broad information-forcing objective is futile. Lawmakers have tried to design legal requirements for contracting out of these rules that will allow the majority of unsophisticated parties to receive and process the relevant information.<sup>185</sup> Despite these efforts, parties in many contractual settings appear to be impervious to the readily available legal information.<sup>186</sup> Existing studies of employment contracting hint that this may be true for terms governing discharge.<sup>187</sup> We should expect similar problems to arise in other legally complex areas such as ERISA benefits, warranty disclaimers, damage limitations, and insurance contracts.

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182. *See id.* at 554.

183. *See id.* at 553.

184. For a similarly creative proposal focused on insurance contracts, see Michelle Boardman, *Insuring Understanding: The Tested Language Defense*, 95 IOWA L. REV. 1075, 1077 (2010).

185. *See* Ayres & Schwartz, *supra* note 175, at 549-50.

186. *See id.* at 550-51.

187. *See* Kim, *supra* note 167, at 106; Rudy, *supra* note 171, at 310-11.

### III. ALTERNATIVE RATIONALES FOR CLAUSE-FORCING DEFAULT RULES

We have seen that legal-information-forcing rules probably fail to inform the majority of unsophisticated people about the legal rules governing their transactions. Accordingly, it is important to explore potential alternative purposes that such rules might serve. I will use the term “clause-forcing” default rule to distinguish these candidate theories from the conventional legal-information-forcing story. This Part examines four possibilities. First, a growing body of scholarship, inspired by behavioral economic theories and cognitive psychology, argues that lawmakers should use default rules to “nudge” market participants towards more efficient or socially desirable choices.<sup>188</sup> Second, the express terms that result from clause-forcing defaults may improve the accessibility of legal information for a distinct subset of legally unsophisticated parties, such as avid comparison shoppers; or those terms could aid reviewers and consumer advocates who seek to inform and protect unsophisticated individuals. Third, a clause-forcing default could facilitate ex post dispute resolution by ensuring that the contract contains a clear statement of the legal rules governing each transaction. Finally, we might understand exculpatory contract language as an effort to opt out of the comparatively expensive legal system in favor of an alternative regime of rights and obligations enforced solely by informal social norms. On this account, judicial scrutiny of the resulting contractual provisions polices the line between law-governed and norm-governed relationships. This Section describes and critiques each of these potential justifications.

#### A. “Nudging” Parties to Make Better Choices

In recent decades, scholars have developed experimental evidence that default rules can be “sticky” in the sense that cognitive and behavioral limitations may prevent individuals from opting out of

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188. See, e.g., THALER & SUNSTEIN, *supra* note 22, at 5; Cass R. Sunstein & Richard H. Thaler, *Libertarian Paternalism Is Not an Oxymoron*, 70 U. CHI. L. REV. 1159 (2003).

the default.<sup>189</sup> An approach dubbed “libertarian paternalism” proposes to use the stickiness of default rules to pursue policy objectives.<sup>190</sup> Leading proponents such as Richard Thaler and Cass Sunstein have celebrated the success of this approach in increasing enrollment rates for employer-provided retirement savings plans.<sup>191</sup> The simple expedient of making automatic enrollment the default, rather than requiring employees to opt in, has dramatically increased the proportion of new hires who participate in these plans.<sup>192</sup> Similar efforts are proposed or underway to alter defaults affecting banking rules, credit card terms, home mortgage escrows, health insurance, employment termination, and privacy policies.<sup>193</sup>

Perhaps the clause-forcing rules I have identified can be defended as efforts to nudge unsophisticated parties to choose more favorable contract terms. I doubt, however, that such a justification can withstand close scrutiny. First, the libertarian paternalist project relies on the premise that once lawmakers have chosen their preferred default, the rule will “stick” and therefore alter the preexisting, and undesirable, market equilibrium.<sup>194</sup> In contrast, clause-forcing rules are, by definition, defaults that provoke opt-outs. Just like the libertarian paternalist nudge, clause-forcing rules favor unsophisticated parties. But rather than changing prevailing terms, a clause-forcing rule simply causes sophisticated parties to include contractual language opting out of the default.

As Lauren Willis has perceptively argued, default rules often become “slippery,” rather than sticky, when one party opposes the default strongly enough to incur the costs of encouraging opt-outs.<sup>195</sup> Indeed, sophisticated parties will tend to oppose defaults more strongly when lawmakers use them to achieve more significant policy objectives.<sup>196</sup> The higher the economic stakes involved, the greater the investment those parties will make to ensure that

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189. See, e.g., THALER & SUNSTEIN, *supra* note 22, at 8.

190. See *id.* at 4-6.

191. See *id.* at 11-13.

192. See *id.* at 114-15.

193. See Estlund, *Just the Facts*, *supra* note 20, at 363-64; Willis, *supra* note 22, at 1159 & nn.14-17; see also Sunstein, *Human Behavior*, *supra* note 22, at 221.

194. See, e.g., THALER & SUNSTEIN, *supra* note 22, at 8.

195. Willis, *supra* note 22, at 1200.

196. See *id.* at 1174.



unsophisticated parties waive the favorable default.<sup>197</sup> Of course, lawmakers could respond by making it more difficult to contract around the default and prohibiting practices that prime consumers to opt out. But the task of making nudges “stick” is likely to require regulation intrusive enough to be indistinguishable from the substantive rules that libertarian paternalists sought to avoid.<sup>198</sup>

Clause-forcing defaults are, by definition, too slippery to fulfill the goal of altering market equilibrium contract terms. Some default rules—like the widely lauded automatic enrollment default for retirement savings—may nudge parties to make better choices.<sup>199</sup> Many others, perhaps even a majority of prevailing default rules, produce nothing more (or less) than a nearly universal practice of opting out.<sup>200</sup> What then are we to make of the contractual boilerplate that these default rules inspire? The remaining Sections of this Part explore potential functions that this exculpatory contract language might serve.

### *B. Lowering Ex Ante Information Costs*

The conventional understanding of legal-information-forcing rules dictates that the resulting contract terms should inform all, or at least most, unsophisticated parties about the targeted information.<sup>201</sup> We have seen, however, that few people read contracts closely enough to dispel their legal ignorance.<sup>202</sup> But what if some individuals value legal information enough to justify reading more carefully? If so, then a clause-forcing rule could sufficiently lower this group’s information costs at the time of contracting to offset the cost of drafting additional contract language.

In one version of this argument, consumers themselves vary in the extent to which they value information about contract terms. We might identify a subset of comparison shoppers who seek to learn not only how well various tax preparation software programs function, but also the legal details of the seller’s license agreement.

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197. *See id.* at 1187-88.

198. *Id.* at 1211-26.

199. *See* THALER & SUNSTEIN, *supra* note 22, at 103-09.

200. *See* Willis, *supra* note 22, at 1159-60.

201. *See, e.g.*, Ayres & Schwartz, *supra* note 175, at 545-46.

202. *See, e.g., id.* at 546.

An often-cited article by Alan Schwartz and Louis Wilde argues that competition among producers to serve these well-informed comparison shoppers provides benefits to all other consumers.<sup>203</sup> Alternatively, product reviewers and consumer advocates may gather and disseminate information to consumers. These intermediaries theoretically lower information costs for consumers. They also potentially magnify the competitive consequences of any differences in contract terms by making those discrepancies more salient.

In either case, clause-forcing defaults ensure that critical information about the legal rules governing each transaction is readily accessible in the written documents for that transaction. On this interpretation, the default rule facilitates comparison shopping and enables product reviewers and consumer advocates. The activities of comparison shoppers and information intermediaries in turn promote allocative efficiency by scrutinizing the proffered terms and exerting some pressure on employers, manufacturers, and service providers to offer a more balanced and reasonable set of terms than they might otherwise be inclined to draft.<sup>204</sup>

Although a clause-forcing rule can undoubtedly lower the ex ante costs of acquiring information about prevailing contract terms, such a rule can do nothing to guarantee that any consumers will find it valuable to read the resulting contract language. Someone shopping for tax preparation software only cares about the end user license terms if they differ meaningfully among otherwise acceptable choices available in the market. If the license for Intuit's TurboTax is indistinguishable from H&R Block's offering, even a savvy purchaser will focus instead on functional differences between the two products. Similarly, standard form insurance contracts vary so little among insurers that even avid comparison shoppers might rationally focus their search exclusively on variable parameters such as price and coverage limits. The uniformity of key employment contract terms also undermines any ex ante information cost justification for a clause-forcing default in this context. Job applicants who confront legally indistinguishable terms governing discharge at every potential employer have no incentive to compare variations in the wording of at-will disclaimers. Instead, they are

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203. Schwartz & Wilde, *supra* note 6, at 637-38.

204. *See id.* at 651-58.

more likely to gather information about each firm's reputation for treating workers fairly and the company's future economic prospects.

The very nature of clause-forcing rules implies that lawmakers expect the overwhelming majority of parties to opt out. Unless those opt outs vary in practically significant ways, even avid comparison shoppers and information intermediaries are unlikely to value the legal information that the resulting express contract terms communicate. Although it is impossible to know how often clause-forcing defaults produce diverse terms, the striking uniformity of contractual boilerplate in many markets suggests that the ex ante value of those terms seldom justifies selecting such a default.

### *C. Ex Post Legal Clarity*

In many contractual settings, it seems doubtful that clause-forcing defaults generate valuable information at the time of contracting. Alternatively, express terms may be desirable not because they inform people about the prevailing legal rule ex ante, but instead because they make the rules clear ex post. At least in theory, greater legal clarity ex post reduces the cost and uncertainty surrounding both settlement negotiations and adjudication. On this account, clause-forcing rules provide no direct benefit for the unsophisticated parties to whom the resulting express contract terms are proffered. These parties benefit only indirectly because greater clarity about their legal rights reduces expected litigation costs. One can easily imagine that over-burdened courts would also be sympathetic to contract practices that facilitate settlement or summary disposition of potential legal disputes. Express terms preclude some litigation entirely by specifying the parties' legal rights, or lack of legal rights, clearly and precisely.<sup>205</sup> For cases that find their way into the judicial system, those same express terms give judges grounds to dismiss complaints or grant summary judgment whenever the terms resolve the dispute.<sup>206</sup>

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205. See, e.g., Charles L. Goetz & Robert E. Scott, *The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms*, 73 CALIF. L. REV. 261, 261-62 (1985).

206. See *id.* at 263.

One bit of evidence lends support to this rationale. Clause-forcing rules most often apply to repeated transactions such as employment, credit, or the mass-market sale of products and services. In settings such as these, sophisticated parties can amortize over many transactions the costs of developing a standardized agreement containing the necessary express contract terms. Clause-forcing rules are far less common for unique transactions of the same underlying value. Single-shot transactions—such as private sales of used cars or hiring casual employees for domestic work—rarely warrant significant investments in express contracting. In these situations, it makes economic sense to rely more heavily on court-provided default terms. The greater judicial tendency to adopt information-forcing rules for repeated transactions is thus broadly consistent with the goal of clarifying the prevailing terms *ex post*.

A quest for *ex post* legal clarity is intuitively appealing, but suffers from both theoretical and practical problems. Lawmakers also could eliminate legal uncertainty by adopting a clear default rule favoring the sophisticated party in these same transactions. What then could explain a judicial preference for clause-forcing rather than market-mimicking default rules? First, courts may not know what terms sophisticated parties desire. Rules such as the *Hadley* requirement of foreseeability and the implied contract erosions of employment-at-will are remarkably fuzzy. Far from being precise rules, they incorporate comparatively vague principles that make the outcomes of specific cases uncertain. The clause-forcing strategy requires mass-market sellers, employers, insurers, and other sophisticated parties to express clearly and precisely their contractual intent. Even if courts could confidently predict the majoritarian contract terms, however, they might feel it would be unseemly to adopt clear defaults that decisively favor sophisticated parties. Instead, they state a comparatively vague default rule,<sup>207</sup> or one that favors unsophisticated parties. At the same time, they invite sophisticated parties to opt out of the default, and then readily enforce whatever express terms the sophisticated party chooses to draft.<sup>208</sup>

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207. See Robert E. Scott, *The Case for Formalism in Relational Contract*, 94 NW. U. L. REV. 847, 848 (2000).

208. See Goetz & Scott, *supra* note 205, at 298.

Clause-forcing rules thus might be interpreted as a judicial strategy to simplify adjudication without appearing to favor unduly the more powerful party to a bargain. Nevertheless, courts often seem to make contract interpretation more complicated and uncertain than absolutely necessary.<sup>209</sup> This apparent ambivalence about enforcement suggests that additional social goals, such as substantive or procedural fairness, qualify the objective of ex post legal clarity. Moreover, an account of information-forcing rules ideally should incorporate a plausible account of what motivates the behavior of contracting parties. Focusing too much on judicial objectives could distort our picture of the role that express terms play in the relations between contracting parties. In the next Section, I consider what these terms might signal about party intent. I then reframe judicial scrutiny of those terms as a decision about the permissible scope of private governance.

#### *D. Opting for Norms Rather Than Law*

Clause-forcing rules inspire parties to draft a vast array of exculpatory contractual boilerplate. These standardized terms prospectively waive liability, narrowly define contractual duties, disclaim warranties, and carefully circumscribe remedies for breach. In addition, these provisions are remarkably uniform both within specific industries and across diverse lines of business. Perhaps a common objective animates such strikingly parallel responses to otherwise distinctive contractual settings. Could drafting parties be using these clauses to signal their desire to supplant the formal legal system of contract enforcement and substitute instead a norm-governed relationship?

The contract language itself abundantly demonstrates antipathy towards formal legal enforcement. By definition, a desire to exclude, limit, or curtail legal rights unifies the use of exculpatory clauses. The more difficult question, however, is whether the constraint of social norms is robust enough to provide adequate assurance of contractual performance. Before endorsing a strategy of opting for norms, lawmakers should surely demand evidence that a meaning-

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209. See Scott, *supra* note 207, at 848.

ful extralegal substitute for judicial enforcement of legal rights exists.

A large literature has documented how informal norms structure many important economic relationships. From ranchers and whalers to diamond merchants, and from cotton dealers to construction subcontractors, scholars have shown that parties often ignore legal entitlements and rely instead on social norms to determine their rights and obligations.<sup>210</sup> Norm-based enforcement particularly thrives in close-knit communities.<sup>211</sup> Frequent social contact, ready access to information, and opportunities for repeat business facilitate both sanctions for misconduct and rewards for good performance.<sup>212</sup> However, strong norms also can arise in larger and less tightly integrated communities.<sup>213</sup> Most humans appear to have a deeply ingrained commitment to reciprocal fairness, and that psychological tendency can support cooperative equilibria even in the absence of opportunities for repeat dealing.<sup>214</sup>

Some combination of reputational concerns and reciprocal fairness often allows informal norms to constrain otherwise powerful market actors who enjoy broad discretion under the law. Edward Rock and Michael Wachter, for example, have argued that a norm requiring just cause for discharge prevails in most U.S. workplaces even though the prevailing employment-at-will default, and the ubiquitous clauses confirming employees' at-will status, preclude most contract claims for unjust termination.<sup>215</sup> Although no one would describe the ties among worldwide users of Facebook as close-knit, those users routinely appeal to widely shared norms when they object to changes in the company's privacy policies.<sup>216</sup> In many other

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210. ELLICKSON, *supra* note 1 (ranchers and whalers); Bernstein, *Creating Cooperation*, *supra* note 25, at 1724-25 (cotton dealers); Bernstein, *Opting Out*, *supra* note 25, at 115 (diamond merchants); Macaulay, *supra* note 25, at 55 (construction subcontractors); Richman, *supra* note 25, at 383 (diamond merchants).

211. *See, e.g.*, Richman, *supra* note 25, at 397-98.

212. *See id.*

213. *See, e.g.*, Bernstein, *Creating Cooperation*, *supra* note 25, at 1725-26.

214. *See, e.g.*, Ernst Fehr & Simon Gächter, *Fairness and Retaliation: The Economics of Reciprocity*, 14 J. ECON. PERSP. 159, 159 (2000).

215. Rock & Wachter, *supra* note 169, at 1917.

216. Brandon Bailey, *Facebook Privacy Controls Changed, Social Network Adds and Subtracts Features*, SAN JOSE MERCURY NEWS (Dec. 12, 2012, 4:38 PM), [http://www.mercurynews.com/ci\\_22177099/facebook-privacy-controls-changed-social-network-adds-and](http://www.mercurynews.com/ci_22177099/facebook-privacy-controls-changed-social-network-adds-and) [http://perma.cc/8CLM-7M2Q].

settings, researchers have found that parties look to norms rather than law to resolve disputes and guide their behavior.<sup>217</sup>

If social norms like these can sufficiently deter opportunistic conduct, then lawmakers could be using clause-forcing rules as part of a broader effort to define the boundary between law and norms. In the domain of judicial enforcement, parties look to a third-party arbiter to interpret their obligations, assess performance, and impose remedies for breach. Informal norms ordinarily overlap and coexist with these legal rights.<sup>218</sup> When disputes arise, parties undoubtedly bargain in the “shadow of the law,” but they also appeal routinely to industry norms and shared notions of fairness.<sup>219</sup> Laboratory experiments and observational studies have shown that the balance between the constraining effect of norms and law varies widely.<sup>220</sup>

Exculpatory boilerplate shifts this balance decisively away from legally enforceable rights and towards informal means of enforcement. It is less obvious, however, what role clause-forcing rules play in this process. Nevertheless, an unfavorable default rule forces sophisticated parties to confront the question of whether to tolerate—or contract around—the resulting legal rights.<sup>221</sup> The system of clause-forcing rules thus places the onus of excluding judicially enforceable rights on the more powerful and legally sophisticated party to these transactions. On this account, the resulting exculpatory clauses (1) confer discretion on the drafting party to administer a norms-based claims settlement procedure, and (2) express that party’s desire to exclude the comparatively costly and less flexible legal system.<sup>222</sup> In short, clause-forcing default rules invite drafting parties to opt out of the legal system. In the

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217. See *supra* note 210.

218. See, e.g., Bernstein, *Opting Out*, *supra* note 25, at 124 (explaining the private arbitration system used by the diamond industry).

219. See, e.g., *id.*

220. See, e.g., ELLICKSON, *supra* note 1 (discussing empirical studies of how disputes are resolved using social norms in the absence of the law); Verkerke, *supra* note 14 (using empirical data to examine the influence of social norms on trends in employment law).

221. See *supra* text accompanying notes 9-17.

222. For a related account of the role of boilerplate terms in consumer contracts, see Bebchuk & Posner, *supra* note 149, at 828-31; and Johnston, *supra* note 149, at 860-64. For suggestions that employment contracting involves a similar tradeoff between law and norms, see Rudy, *supra* note 171; Verkerke, *supra* note 14; and Verkerke, *supra* note 8.

place of legally enforceable rights, these parties offer their contractual partners a system of enforcement based on social norms.<sup>223</sup> To the extent that courts enforce the resulting exculpatory contract language, they accept and even endorse this substitution of social norms for legal rights.

As many critics of modern consumer contract practices have observed, courts ordinarily enforce the exculpatory boilerplate that clause-forcing rules provoke.<sup>224</sup> Contract drafters ordinarily may preclude consumers, workers, insurance purchasers, and other similar parties from asserting a wide variety of default legal entitlements.<sup>225</sup> Within this broad domain, legal-information-forcing rules ironically allow private parties to displace legal rights altogether and substitute a system governed primarily by informal social norms.

Unsurprisingly, however, judges sometimes refuse to cede their authority to resolve disputes about contractual rights and to award remedies for breach. Doctrines such as unconscionability, duress, and misrepresentation allow courts to intervene selectively when they become convinced that a drafting party has abused its power. For example, U.C.C. § 2-719(3) provides that “[c]onsequential damages may be limited or excluded *unless the limitation or exclusion is unconscionable.*”<sup>226</sup> The interpretive canon of *contra proferentem* and the insurance law doctrine that protects an insured’s “reasonable expectation” of coverage similarly constrain a contract drafter’s ability to displace legal obligations.<sup>227</sup>

If clause-forcing rules principally invite drafting parties to signal unequivocally their desire to “opt for norms,” then judicial decisions enforcing—or refusing to enforce—these exculpatory terms define the boundary between formal and informal enforcement. Somewhat analogously, pre-dispute arbitration agreements allow drafting parties to select an arbitral forum in lieu of a judicial forum, for

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223. See *supra* note 210 (citing sources).

224. See RADIN, *supra* note 19, at 7-8.

225. Rakoff, *supra* note 19, at 1177-79.

226. U.C.C. § 2-719(3) (2012) (emphasis added).

227. Some commentators have identified the potentially information-forcing function of the *contra proferentem* doctrine, see, for example, Ayres, *supra* note 31, at 596, but not the canon’s role in policing the line between law and norms.



dispute resolution.<sup>228</sup> In theory at least, arbitration preserves parties' substantive legal rights.<sup>229</sup> As compared to the explicitly exculpatory clauses we have been considering, an agreement to arbitrate determines only who will resolve a dispute, and not what substantive legal rules will apply to that dispute. In principle, arbitration reduces dispute resolution costs solely by employing more streamlined and expeditious procedures, such as limited discovery, sharply reduced motions practice, prompt evidentiary hearings, simplified procedural rules, and strict limits on grounds for appeal. However, the impulse underlying pre-dispute arbitration clauses closely mirrors the goals that drafting parties pursue with exculpatory contract terms.<sup>230</sup> For this reason, judicial approaches to arbitration agreements and academic commentary on those decisions often parallel their treatment of exculpatory boilerplate.

Just as the issue of arbitration has provoked strongly divergent views, identical controversies animate the debate about expressly exculpatory contract clauses. Many scholars fear that boilerplate threatens to eviscerate the normative foundations of contractual obligation. According to these critics, consumers, workers, and others who confront standardized contracts of adhesion cannot meaningfully consent, and their passive role in these transactions may even undermine our democratic order.<sup>231</sup> Another group of scholars offers a more sanguine assessment of contractual boilerplate. In their view, exculpatory terms economize on dispute

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228. See *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 26 (1991); *Mitsubishi Motors v. Soler Chrysler Plymouth*, 473 U.S. 614, 628 (1985).

229. See, e.g., *Mitsubishi Motors*, 473 U.S. at 628 ("By agreeing to arbitrate ... a party does not forgo the substantive rights afforded by the statute; it only submits to their resolution in an arbitral, rather than a judicial, forum."). More recent Supreme Court decisions have focused more single-mindedly on the issue of party consent and on vindicating the pro-arbitration policy of the Federal Arbitration Act. We can see the Court's reasoning shift from concern about effectively vindicating substantive rights to a consent-based theory of enforcement in *Stolt-Nielsen S.A. v. AnimalFeeds Int'l Corp.*, 559 U.S. 662 (2010) (beginning the shift from a forum-selection rationale for enforcing arbitration agreements to a consent-based rationale), *AT&T Mobility v. Concepcion*, 131 S. Ct. 1740 (2011) (emphasizing party consent), and *Am. Express Co. v. Italian Colors Rest.*, 133 S. Ct. 2304 (2013) (rejecting the "effective vindication" doctrine).

230. For a related discussion of how arbitration clauses might lower the costs of resolving disputes over consumer transactions, see Johnston, *supra* note 149.

231. See, e.g., RADIN, *supra* note 19, at 7-8.

resolution costs and ordinarily pose no significant threat to adhering parties or to our social and political order.<sup>232</sup>

It is far beyond the scope of this Article to arbitrate between these competing perspectives on modern contract practices. Instead, I have tried to illuminate how clause-forcing rules inspire drafters to generate copious quantities of exculpatory boilerplate. Those rules may exist not because the resulting contractual language informs any unsophisticated parties or clarifies contract terms at the time of adjudication. Rather, these clause-forcing default rules may simply give sophisticated parties a good reason to state expressly that they wish to exclude legal enforcement to the greatest extent permissible. Lawmakers then must establish additional mandatory rules to determine precisely how far drafting parties may go in opting for norms rather than law.

#### *E. Some Potential Policy Implications*

Lawmakers currently assume uncritically that unsophisticated parties read and understand formal contract provisions. The available evidence, however, suggests that parties most often ignore such provisions entirely.<sup>233</sup> If the legal-information-forcing argument, on which courts often rely, lacks a sound empirical foundation, then perhaps these rules serve some other purpose. My goal in this Part has been to explore plausible alternatives and analyze whether clause-forcing defaults might play a more empirically defensible role. The discussion above has considered in a very preliminary way several candidate justifications for clause-forcing rules.

Before we examine how those alternative justifications might inform future doctrinal development, it is important to briefly reconsider a strategy that could potentially salvage the conventional legal-information-forcing rationale. Courts might try to reshape contract doctrine in an effort to make these legal-information-forcing rules dispel legal ignorance more effectively. Case law has thus far sought principally to promote greater prominence and clarity of express contract terms.<sup>234</sup> Courts appear to believe that

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232. See, e.g., Bebchuk & Posner, *supra* note 149; Johnston, *supra* note 149.

233. See *supra* note 19.

234. *Id.*

clearly drafted and typographically prominent terms are more informative.<sup>235</sup> Further study could reveal whether these or some other doctrinal innovations hold the greatest promise for better informing unsophisticated parties.

Currently, however, there is no empirical basis for determining what techniques will work. Contemporary scholars such as Cass Sunstein somewhat blithely assume that a combination of express terms and disclosures will convey the targeted information.<sup>236</sup> Similarly, Cynthia Estlund proposes that a “strong default” of just cause will remedy workers’ ignorance about their at-will status.<sup>237</sup> However, introspection and the available empirical evidence suggest that most of these clauses and the closely analogous mandated disclosures go unread.<sup>238</sup> Legal ignorance thus persists despite the widespread availability of detailed legal information about the terms governing these transactions.

If the problem is that no one reads contracts, then a truly effective doctrine to combat legal ignorance may need to require parties to read their agreements before signing. Sophisticated parties could be permitted to enforce exculpatory terms only after quizzing their comparatively unsophisticated contractual partners about the content and effect of those provisions.<sup>239</sup> If, however, lay people remain unable to understand these agreements even after being compelled to read them, then perhaps courts would require an attorney to be present when contracts are formed. The enormous costs associated with these approaches should make us extremely cautious to embrace them. If, for example, efficiency only requires that reviewers, consumer advocates, and avid comparison shoppers read written agreements,<sup>240</sup> then it would be quite wasteful to impose costly duties that apply to every transaction. However, if our social goal is to ensure that each individual knows and understands the meaning of each contract she enters, then lawmakers must

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235. *Id.*

236. Sunstein, *Switching the Default Rule*, *supra* note 22, at 110.

237. Estlund, *How Wrong Are Employees*, *supra* note 20, at 23-27. *But see* Estlund, *Just the Facts*, *supra* note 20 (proposing a mandatory disclosure regime for employment).

238. *See, e.g.*, Ben-Shahar & Schneider, *supra* note 3, at 671-72; Willis, *supra* note 6.

239. Both Ayres & Schwartz, *supra* note 175, and Boardman, *supra* note 184, propose somewhat-less-rigorous versions of this process.

240. *See supra* text accompanying notes 202-03.

develop some firm empirical basis for believing that particular forms of regulation will be cost effective.

Alternatively, courts could abandon the pretense that formal terms inform unsophisticated parties at all. Perhaps consumers and workers are rationally ignorant about express contract terms.<sup>241</sup> The cost of reading and understanding contractual terms may far exceed the expected value of being better informed about prevailing law.<sup>242</sup> Parties thus may prefer to rely on informal norm-based mechanisms of contract enforcement. If so, then efforts to force these parties to become aware of the terms governing each transaction are socially wasteful.

Courts might nevertheless encourage sophisticated parties to draft express terms when that practice makes sense for other reasons. For example, comprehensive express terms could make contract terms clear ex post and thus reduce the costs of dispute resolution.<sup>243</sup> However, embracing such an objective implies that courts should reorder their regulatory priorities. Requirements of typographical prominence in no way promote the goal of ex post legal clarity; nor would that objective provide any reason to impose onerous requirements on the process of contract formation. Instead, courts could focus almost exclusively on requiring drafting parties to eliminate any possible ambiguity from the terms themselves without worrying unduly about how those terms became part of the contract.

Alternatively, exculpatory clauses may serve solely as a signal that drafting parties wish to elect a norm-governed relationship. If so, then lawmakers need to confront this fact and develop defensible rules to police the boundary between law and norms. They must decide when drafting parties may opt for norm-based enforcement, and when courts should instead refuse to enforce exculpatory clauses. These limits could protect individuals from mistakenly accepting inefficient contract terms. Or courts might impose constraints to vindicate other compelling public policies. As we have seen, scholars differ sharply about the economic utility and social

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241. See *supra* text accompanying notes 172-73.

242. See Verkerke, *supra* note 173. Those arguments were further articulated by Rudy, *supra* note 171, at 340-41.

243. See *supra* Part III.C.

consequences of exculpatory contractual boilerplate.<sup>244</sup> It is well beyond the scope of this Article to resolve that academic debate. Nevertheless, my analysis shows the close connection between clause-forcing rules and exculpatory boilerplate. Existing default rules encourage sophisticated parties to incorporate express contract language opting out of those defaults.

Of course, if no persuasive argument exists to justify default rules that encourage express opt-outs, then courts should perhaps consider abandoning clause-forcing rules entirely. Doing so, however, would require courts to select an alternative default rule. Lawmakers can easily remedy useless mandatory disclosure rules by the simple expedient of eliminating the dysfunctional legal requirement. In contrast, an unwanted clause-forcing rule must be replaced with something else. A conventional majoritarian default rule would almost certainly replicate the exculpatory boilerplate that the clause-forcing default currently inspires. Sophisticated drafting parties would probably opt out of any alternative default rule that deviated significantly from the current contractual pattern.

One final possibility is that courts have adopted clause-forcing rules for reasons that they are simply unwilling to express. For example, it may be difficult for a court to acknowledge that most people derive no benefit from knowing the express terms of their agreements. Or judges may balk at the prospect of adopting a majoritarian default rule that so clearly favors the more sophisticated and powerful party to a contract. Or the legal fiction that express terms are truly informative may be easier to reconcile with the judicial role than the reality that most sophisticated drafting parties display pervasive antipathy to legal enforcement. On this account, the true explanation for clause-forcing rules may combine several of the alternative rationales I have explored in this Part. Nevertheless, we can expect lawmakers to continue to talk about clause-forcing rules as if express terms provide valuable legal information.

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244. *See supra* Part II.B.2.

## CONCLUSION

This Article argues that surprisingly many contract default rules have the ostensible purpose of inducing sophisticated parties to draft express contract language that will inform their contractual partners about the legal rules governing a particular transaction. It also suggests that this legal-information-forcing objective often founders because people sign contracts without reading or understanding their terms. It is theoretically possible that courts could design legal-information-forcing rules that would be truly informative, but we lack sufficient empirical data about how people process legal information to be able to fashion such rules with any confidence.

Recognizing the potential futility of attempts to inform most contracting parties about complex legal rules, this Article explores several alternative justifications for doctrines that encourage sophisticated parties to draft express contract terms. Although these clause-forcing rules are unlikely to “nudge” parties towards better terms, the resulting express contract language may lower information costs *ex ante* and thus facilitate the activities of avid comparison shoppers, product reviewers, and consumer advocates. Comprehensive written terms could also promote *ex post* legal clarity and thereby reduce the costs of resolving disputes. Finally, a litany of exculpatory clauses allows parties to contract out of the comparatively expensive legal system of dispute resolution in favor of a regime governed by informal social norms. On this account, clause-forcing rules encourage sophisticated drafting parties to signal their preference for a norm-governed relationship, and lawmakers then demarcate the boundary between law and norms by deciding whether to enforce exculpatory clauses.

Each of these reasons for adopting rules that encourage parties to draft exculpatory express contract terms sidesteps problems that afflict the conventional legal-information-forcing argument. To the extent that any of these stories justify using clause-forcing rules, however, lawmakers should reorient related doctrines to serve their goals more effectively. I have offered a very preliminary account of how existing law might be reformulated. But further theoretical and

empirical work will be needed to develop any definitive prescription for reform. In the meantime, my analysis of these alternative justifications shows the conceptual poverty of accounts that presume express contract terms inform the majority of unsophisticated parties. Any successful defense of the existing legal regime must necessarily venture beyond the conventional understanding of legal-information-forcing rules.