

## CONTRACT LAW NOW—REALITY MEETS LEGAL FICTIONS

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*Modern contract law is designed to achieve a fundamental objective, namely, to ensure that voluntary agreements between private parties are legally binding. The appropriateness of this objective and the assumptions underlying it are rarely questioned. Legal scholars, practitioners, and policymakers alike presuppose that the binding nature of contracts is a desirable and positive feature of our legal system. But are the assumptions underlying the modern contract system sound? Do people behave in the way that contract law supposes? And are the concepts of voluntary, informed consent and freedom from state interference really the hallmarks of the modern contract system? This article explores and seeks to answer these questions. In so doing, it reveals an overlooked gap between theory and practice that calls into doubt the notion that contract law has anything to do with freedom and voluntary consent.*

*Drawing on leading social science literature, this article seeks to make two contributions. First, the article shows that the assumptions underlying the modern contract law framework are flawed both theoretically and practically. Many contracts are not entered into voluntarily by rational actors, and the state regularly interferes.*

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*Imbalances of power, not freedom and consent, form the cornerstones of the modern system of contract law. Second, the article attempts to reveal the way contract law promotes and privileges these power imbalances. While the positions staked out in this article are admittedly foreign to conventional contract law theory, they are far from radical. Instead, they flow naturally from well-accepted social science insights, including the work of Legal Realists, Critical Legal Studies scholars, relational contract theorists, and, more recently, the field of behavioral law and economics. What is striking is not that the positions advanced here depart from conventional belief, but that the lessons from leading social science research have had, to date, so little impact on contract doctrine. This article seeks to change that.*

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## INTRODUCTION

Modern contract law is crafted to achieve a fundamental objective—to ensure that voluntary agreements between private parties are legally binding.<sup>1</sup> Several assumptions about how people behave serve to justify this objective. Modern contract law assumes that contractual obligations are private transactions, voluntarily undertaken by informed, rational actors, in a market mostly free of state interference.<sup>2</sup> Once a contract is properly formed, parties are required to comply with the agreed-upon obligations. Compliance is ensured through state power,<sup>3</sup> even if in hindsight one party has made a “bad bargain.”<sup>4</sup>

The appropriateness of this objective (to create binding legal obligations) and the assumptions underlying it are rarely questioned. Legal scholars, practitioners, and policymakers alike presuppose, without serious analysis, that the binding nature of contracts is a desirable and positive feature of our legal system.<sup>5</sup> Indeed, what could be wrong in requiring parties to keep their promises? That the law holds people to their promises is perceived as fair because contract law purports to reduce unequal bargaining power and other inequities to make agreements a product of voluntary, informed consent.<sup>6</sup> But are the assumptions underlying the modern contract system sound? Do people behave in the way that contract law supposes? And are the concepts of voluntary, informed consent and freedom from state interference really the hallmarks of the modern contract system? This article explores and seeks to answer these questions. In so doing, it reveals an overlooked gap between theory and practice that calls into doubt the notion that contract law has anything to do with freedom and voluntary consent.

Drawing on leading social science literature, this article seeks to make two contributions. First, the article shows that the assumptions underlying the modern contract law framework are flawed both theoretically and practically.<sup>7</sup> Many contracts are not entered into voluntarily by rational actors, and the state regularly interferes.

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1. See RESTatement (SECOND) OF CONTRACTS § 1 cmt. a, c, g (1981); see also *infra* Part I.A.
  2. See *infra* text accompanying notes 55–65 (discussing the listed assumptions).
  3. See *infra* Part II.A.
  4. See *infra* text accompanying notes 331–32 (discussing bad bargains specifically).
  5. See generally Danielle Kie Hart, *Contract Formation and the Entrenchment of Power*, 41 LOY. U. CHI. L.J. 175, 199–204 (2009); *infra* notes 55–64 and accompanying text (discussing suggested, positive aspects of modern contract law).
  6. See *infra* Part I.A; Hart, *supra* note 5, at 175–82.
  7. See *infra* Part II.A.

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Imbalances of power, not freedom and consent, form the cornerstones of the modern system of contract law.<sup>8</sup> Second, the article attempts to reveal the way contract law promotes and privileges these power imbalances.<sup>9</sup> While present remedial mechanisms focused on disclosure are commonly believed to mitigate power inequities, in reality those mechanisms do the opposite. Instead, the article shows that unequal bargaining power is effectively institutionalized in the modern contract law system, and demonstrates how that system surreptitiously promotes misuse and abuse of power.<sup>10</sup>

In advancing these positions, the article breaks sharply from the current literature. For example, while many contract-law scholars extol the virtue of disclosure statutes as a way to address unequal bargaining power,<sup>11</sup> the article argues that those disclosure requirements are ineffective at best, and, at worst, exacerbate the problem.<sup>12</sup>

While the positions staked out in this article are admittedly foreign to conventional contract law theory, they are far from radical. Instead, they flow naturally from well-accepted social science insights, including the work of Legal Realists, Critical Legal Studies scholars, relational contract theorists, and, more recently, the field of behavioral law and economics.<sup>13</sup> What is striking is not that the positions advanced here depart from conventional belief, but that the lessons from leading social science research have had, to date, so little impact on contract doctrine. This article seeks to change that.

With this in mind, the article proceeds in three parts. In Part I, the article focuses on how the modern contract law system<sup>14</sup> legitimizes itself through the binding nature of agreements. The article also explores the fundamental assumptions that underlie contract law and the manner in which disclosure statutes embrace those underlying assumptions. In Part II, the article demonstrates how those

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8. See *infra* Part III.

9. See *infra* Part III.

10. See *infra* Part III.B.

11. See *infra* text accompanying notes 111–14 (discussing purposes of disclosure statutes).

12. See *infra* Part III.B.

13. See *infra* Part II.A.

14. The terms “modern contract law system” and “modern contract law” are used interchangeably throughout the article. In using either term, I am referring to the rules of contract law, its animating norm(s), and the assumptions that underlie those rules. See *infra* text accompanying notes 53–65 (discussing the underlying assumptions). The context in the article should make it clear whether the rules, norm(s), or assumptions are being discussed.

assumptions are flawed, both in theory and in practice. In so doing, Part II exposes the extent to which state power is ever present in the modern contract law system. Finally, in Part III, the article shows how unequal bargaining power is institutionalized and how power is concealed within the modern contract law system to the detriment of parties with less bargaining power. The article demonstrates how, contrary to conventional wisdom, disclosure statutes frustrate, rather than aid, in reducing the negative effects of bargaining power inequities. Part III also reveals how modern contract law gives license to parties with more bargaining power, *if they so choose*,<sup>15</sup> to impose “bad bargains” on other contracting partners with impunity. The article concludes on a provocative note. Once the inequities girding the modern contract law system are unmasked, they suggest that we cannot continue to ignore them, but instead must more meaningfully discuss what, if anything, can or should be done.

A final point before proceeding: The questions raised and legal doctrines critiqued in this article are not simply matters of high-minded theory—they have pragmatic and real life implications. The recent subprime-mortgage debacle is illustrative of how the modern contract law system enforces “bad bargains” and where bargaining power inequities lead to bad results. To concretely illustrate the arguments made, this article will rely on the following hypothetical involving a subprime home mortgage loan,<sup>16</sup> one in which disclosure statutes are implicated. The specific statutes include the Truth in Lending Act (TILA)<sup>17</sup> and the Real Estate Settlement Procedures Act (RESPA).<sup>18</sup>

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15. Professor Daniel Barnhizer argues that the fact that “one side has great visible, real power in the bargaining process may just as easily permit that party to make concessions.” Daniel D. Barnhizer, *Inequality of Bargaining Power*, 76 U. COLO. L. REV. 139, 177 (2005) [hereinafter Barnhizer, *Inequality*]. While this is correct, the significant thing to keep in mind is that it is still a choice whether to impose a bad bargain or not and the only party with the capacity to exercise that choice is the party with superior bargaining power.
  16. An accepted definition of a “subprime loan” is one with an annual percentage rate (APR) that is three or more points higher than the treasury rate for a security of the same maturity. Oren Bar-Gill, *The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 CORNELL L. REV. 1073, 1088 (2009).
  17. 15 U.S.C. §§ 1601–1615, 1631–1649, 1661, 1667(f) (2000 & Supp. III 2004) (implemented by the Federal Reserve Board via Regulation Z, 12 C.F.R. § 226.1 (2005)).
  18. Real Estate Settlement Procedures Act of 1974, 12 U.S.C. §§ 2601–2617 (2006) (implemented by the Department of Housing and Urban Development, 24 C.F.R. pts. 3500, 3800 (2008)).

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The lender in the hypothetical is CitiMortgage. CitiMortgage was chosen because it is a mortgage company<sup>19</sup> and a subsidiary of Citigroup, Inc.,<sup>20</sup> it was also one of the biggest subprime mortgage lenders in the country.<sup>21</sup> The borrower is Mary Smith, a 32-year-old, single, African-American woman. Research and studies show that subprime loans were predominantly made to younger, single or divorced women of color living in minority neighborhoods.<sup>22</sup>

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19. Mortgage companies, as opposed to depository institutions, like a bank, were responsible for originating the bulk of subprime loans. Bar-Gill, *supra* note 16, at 1090.
  20. This information was taken from the Citi website: Citi, <http://www.citigroup.com/citi/business/brands.htm> (last visited Nov. 26, 2011).
  21. In 2006, CitiMortgage was the fifth top subprime lender, based on market share. See IVY L. ZELMAN ET AL., CREDIT SUISSE, MORTGAGE LIQUIDITY DU JOUR: UNDERESTIMATED NO MORE 22 exhibit 14 (2007), available at <http://www.recharts.com/reports/CSHB031207/CSHB031207.html> (listing the market shares of the top subprime lenders in 2006 as follows: Wells Fargo 13.0%, HSBC Finance 8.3%, New Century 8.1%, Countrywide Financial 6.3%, CitiMortgage 5.9%, WMC Mortgage 5.2%, Fremont Investment 5.0%, Ameriquest 4.6%, Option One 4.5%, First Franklin 4.3%, Washington Mutual 4.2%, Residential Funding 3.4%, Aegis Mortgage 2.7%, American General 2.4%, Accredited Lenders 2.3%). The report also noted that the top fifteen lenders captured 80.5% of the market. *Id.*
  22. See ALLEN J. FISHBEIN & PATRICK WOODALL, CONSUMER FED'N OF AMERICA, WOMEN ARE PRIME TARGETS FOR SUBPRIME LENDING: WOMEN ARE DISPROPORTIONATELY REPRESENTED IN HIGH-COST MORTGAGE MARKET 1–4, 6–11, 15 (2006), available at <http://www.consumerfed.org/pdfs/WomenPrimeTargetsStudy120606.pdf> (finding that women, particularly African-American and Latino women, were more likely to receive subprime mortgages than men); CAPITAL AREA ASSET BUILDERS ET AL., SUBPRIME MORTGAGE LENDING IN THE DISTRICT OF COLUMBIA: A STUDY FOR THE DEPARTMENT OF INSURANCE, SECURITIES AND BANKING 1, 7, 10, 14–15 (2008), available at [http://www.trfund.com/resource/downloads/policypubs/Subprime\\_Lending\\_Study\\_6\\_20\\_08\\_DC.pdf](http://www.trfund.com/resource/downloads/policypubs/Subprime_Lending_Study_6_20_08_DC.pdf) (finding that subprime loans were disproportionately made to low income, African-American borrowers); CONSUMERS UNION SWRO, WOMEN IN THE SUBPRIME MARKET 1–2 (2002), available at <http://www.consumersunion.org/pdf/women-sub.pdf> (data from Texas); IRA GOLDSTEIN ET AL., THE REINVESTMENT FUND, MORTGAGE FORECLOSURE FILINGS IN MARYLAND: A STUDY BY THE REINVESTMENT FUND FOR THE BALTIMORE HOMEOWNERSHIP PRESERVATION COALITION 6, 26, 34 (2008), available at <http://www.trfund.com/resource/downloads/policypubs/MarylandForeclosure.pdf> (finding that African-Americans living in predominantly African-American neighborhoods received a higher percentage of subprime loans than other racial categories, and that most loans in foreclosure were obtained for home purchases rather than refinances); Manny Fernandez, *Study Finds Disparities in Mortgages by Race*, N.Y. TIMES, Oct. 15, 2007, <http://www.nytimes.com/2007/10/15/nyregion/15subprime.html?r=1> (citing a study conducted by New York University's Furman Center for Real Estate and Urban Policy, which indicated that “[h]ome buyers in predominantly black and Hispanic

African-American women were disproportionately represented among this demographic.<sup>23</sup>

In 2006, CitiMortgage sold Ms. Smith a subprime loan to purchase a single-family residence<sup>24</sup> in a predominantly minority neighborhood in exchange for a mortgage on the house purchased. CitiMortgage sold Ms. Smith this loan even though she did not actually qualify for it.<sup>25</sup> Some of the terms included in the loan were a high prepayment penalty provision,<sup>26</sup> very high origination<sup>27</sup> and post-origination

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neighborhoods in New York City were more likely to get their mortgages last year from a subprime lender than home buyers in white neighborhoods with similar income levels").

23. FISHBEIN & WOODALL, *supra* note 22, at 1 (finding that women, particularly African-American and Latino women, were more likely to receive subprime mortgages than men); *accord* CONSUMERS UNION SWRO, *supra* note 22, at 1–4 (data from Texas).
24. In 2006, “42.4 percent of first-lien subprime loans were purchase loans.” Bar-Gill, *supra* note 16, at 1089.
25. Qualifying for a loan is the process by which a person applies for a loan and the lender determines the likelihood that the borrower will be able to repay the loan according to its terms. Nathaniel R. Hull, Comment, *Crossing the Line: Prime, Subprime, and Predatory Lending*, 61 ME. L. REV. 287, 288 (2009). Lenders generally use several established criteria to determine whether a borrower qualifies for a home mortgage loan: the borrower’s credit score—usually a FICO score higher than 660; documentation of income, debt, employment, and assets (including financial resources and other property or collateral); and “a loan amount less than the maximum size loan that Fannie Mae and Freddie Mac are allowed to purchase.” *Id.* at 292 & nn.33–34; *see also* *Do You Qualify for a Mortgage Loan?*, INCHARGE DEBT SOLUTIONS, <http://www.incharge.org/money-101/buying-a-home/do-you-qualify-for-a-mortgage-loan> (last visited Nov. 26, 2011). If a borrower satisfies the criteria, she qualifies for a prime mortgage, which is a mortgage at the best interest rate then available. If she does not meet the criteria, then she generally only qualifies for a subprime mortgage, which is a mortgage at a higher interest rate. Hull, *supra* at 292; *see also* *supra* note 16 (defining subprime loan). To say that Mary Smith did not qualify for the subprime mortgage loan she was sold by CitiMortgage, therefore, means not only that she did not satisfy one or more of the lending criteria, but also that she was unlikely to be able to repay the loan according to its terms.
26. A common feature of subprime loans was a steep prepayment penalty term. Estimates suggest that between 64% and 98% of subprime loans included a prepayment penalty. Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 MD. L. REV. 707, 763 (2006); *see also* Bar-Gill, *supra* note 16, at 1101 (putting the number at 70%). Significantly, the steep prepayment penalty provisions made it prohibitively expensive for many borrowers to refinance out of their original loans at all, let alone prior to the upward adjustment of their adjustable rate mortgages. *See* CAPITAL AREA ASSET BUILDERS ET AL., *supra* note 22, at 2; *cf.* Catherine M. Brennan, *Unintended Consequences: Investor Fallout from the Mortgage Crisis*, 28 No. 12 BANKING & FIN. SERVICES POL’Y REP. 1 (Dec. 2009); Bar-Gill, *supra* note 16, at 1102 (“Prepayment penalties make it more difficult for borrowers to evade the escalating payments.”). To put prepayment penalties into some perspective, Bar-Gill writes:

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fees,<sup>28</sup> which totaled 20% of the loan amount,<sup>29</sup> and a 2/28 adjustable-rate mortgage (ARM).<sup>30</sup> CitiMortgage properly disclosed to Ms. Smith all of the information required by TILA and RESPA, the relevant consumer protection statutes. CitiMortgage did not, however, disclose to Ms. Smith that she did not qualify for the loan. Two years later, Ms. Smith defaulted on her loan.

### I. BINDING CONTRACTS

The starting point of the analysis is the way in which the modern contract law system legitimizes itself through the binding nature of agreements. “Binding” means two different but related things<sup>31</sup>—first, “binding” means that the contract is valid as between the parties (because it satisfies contract law’s formation requirements), and second, it means that the rights and obligations set forth in that contract will be enforced by the state on behalf of one of the parties

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The penalty amount is usually expressed as a percentage of the outstanding balance on the loan, up to 5 percent, or as the sum of a specified number of months, commonly six months, worth of interest payments. This is a significant amount. For example, a 3 percent penalty on a \$200,000 balance amounts to \$6,000.

*Id.* at 1101 (footnote omitted).

27. *Id.* at 1077 (“[O]rigination fees [include] a credit check fee, an appraisal fee, a flood certification fee, a tax certification fee, an escrow analysis fee, an underwriting analysis fee, a document preparation fee and separate fees for sending emails, faxes and courier mail . . . .”); Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PA. L. REV. 1, 39 (2008) (“The Wall Street Journal points to one possibility: mortgage brokers received 27% higher fees for originating subprime mortgages than for originating conforming loans.”).
28. Bar-Gill, *supra* note 16, at 1077 (“[P]ost-origination fees [include] late fees, foreclosure fees, . . . and dispute-resolution or arbitration fees.”).
29. *Id.* (“[O]rigination and post-origination] fees can add up to thousands of dollars, or up to 20 percent of the loan amount.”). According to Professor Lauren Willis, “[w]hen financed into the loan, origination fees and ancillary products form the basis for additional interest charges over the life of the loan.” Willis, *supra* note 26, at 725.
30. A 2/28 adjustable rate mortgage is one that has a fixed interest rate for the first two years of the loan and then an adjustable interest rate for the remaining twenty-eight years of the loan. *Mortgage Reference Library: 2/28 Adjustable Rate Mortgage*, BROKER OUTPOST, <http://www.brokeroutpost.com/reference/27353.htm> (last visited Nov. 26, 2011); *see also* Bar-Gill, *supra* note 16, at 1098 (“According to the FRB, approximately three-fourths of originations in securitized subprime ‘pools’ from 2003 to 2007 were ARMs or hybrids with two- or three-year ‘teaser’ rates followed by substantial increases in the rate and payment (so-called ‘2-28’ and ‘3-27’ mortgages).”).
31. *See infra* Part II.A. *See generally* Hart, *supra* note 5, at 204–16 (articulating in detail both aspects of “being bound” to a contract).

over the objection of the other, now “resisting party.”<sup>32</sup> Modern contract law relies on several fundamental assumptions to justify binding people to their contracts and the modern system’s reliance on disclosure statutes. If these assumptions are correct, then it is perfectly acceptable to make contracts binding<sup>33</sup> and to rely on disclosure statutes as a remedial mechanism.

#### A. *The Modern Contract Law System*

Contract law allegedly shifted in the 1930s<sup>34</sup> from the classical to the modern system.<sup>35</sup> Modern contract law is different from classical

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32. This latter statement in the text is true because, in reality, contract law is primarily concerned with holding a “resisting party,” that is, a party that no longer wants to be bound by the contract, to the contract. If both parties were performing and had no objections to the other’s performance, there would be no legal problem for contract law to be concerned with. Conversely, if both parties decided they wanted to walk away from the contract, there is again no legal problem presented, because neither party would be complaining about the other’s performance or lack thereof. Hence, contract law is especially concerned with enforcing a contract against one of the parties, specifically, the party who no longer wants to be bound by it. *See* William Joseph Singer, *The Legal Rights Debate in Analytical Jurisprudence from Bentham to Hohfeld*, 1982 WIS. L. REV. 975, 987 n.14 (1982) (“Enforcement of contracts does not merely ratify the results of individual will; it chooses whose will to enforce by overriding the will of the one who breached the contract.”); Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553, 562 (1933) [hereinafter Cohen, *Contract*] (“[I]n enforcing contracts, the government does not merely allow two individuals to do what they have found pleasant in their eyes. Enforcement, in fact, puts the machinery of the law in the service of one party against the other.”).
  33. Even the party seeking enforcement would need to be “bound” to the contract, through formation and enforcement, to assert its claims under it. Therefore, contracts must be binding on both parties.
  34. This version of the evolution of contract law is not without its critics. *See, e.g.*, ROY KREITNER, CALCULATING PROMISES: THE EMERGENCE OF MODERN AMERICAN CONTRACT DOCTRINE 7 (2007) (commenting that the tendency to read the history of contract law as an evolutionary process in which “contract was always about individuals creating their own obligations” is “ahistorical and thus in some sense a distortion”); GRANT GILMORE, THE DEATH OF CONTRACT 3–4 (1974).
  35. The classical legal period lasted roughly seventy years, from 1860 to the 1930s. *See* AMERICAN LEGAL REALISM, at xi (William W. Fisher III et al. eds., 1993) [hereinafter LEGAL REALISM]; Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law*, 28 SEATTLE U. L. REV. 1, 3 (2004) [hereinafter Feinman, *Un-Making*] (noting that classical legal thought was dominant from 1870 to 1920); Joseph William Singer, *Legal Realism Now*, 76 CALIF. L. REV. 465, 478 (1988) [hereinafter Singer, *Realism*] (setting the time period of classical legal thought as 1860–1940). *But see* Elizabeth Mensch, *The History of Mainstream Legal Thought, in THE POLITICS OF LAW: A PROGRESSIVE CRITIQUE* 23, 28 (David Kairys ed., 3d ed. 1998) [hereinafter Mensch, *History*] (setting the time period as 1885–1935). The shift to modern contract law lasted approximately sixty years, from the 1930s through the

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contract law in many ways. For example, modern contract law relies on standards rather than rigid, technical rules;<sup>36</sup> makes the context in which a contract was formed matter in a couple of important respects;<sup>37</sup> and gives expanded recognition to several “contract policing”<sup>38</sup> doctrines<sup>39</sup> and to reliance and restitution as alternatives to a traditional contract.<sup>40</sup>

Unlike classical contract, modern contract law also acknowledges that markets are not perfect<sup>41</sup> and, in fact, contain imperfections, primarily in the form of information asymmetries and bargaining

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1990s. Feinman, *Un-Making*, *supra* at 11–14; Ralph James Mooney, *The New Conceptualism in Contract Law*, 74 OR. L. REV. 1131, 1133 (1995) [hereinafter Mooney, *New Conceptualism*].

36. E. Allan Farnsworth, *Some Prefatory Remarks: From Rules to Standards*, 67 CORNELL L. REV. 634, 634 (1982) [hereinafter Farnsworth, *Prefatory Remarks*]; Jay M. Feinman, *The Significance of Contract Theory*, 58 U. CIN. L. REV. 1283, 1287 (1990) [hereinafter Feinman, *Theory*]; Charles L. Knapp, *An Offer You Can’t Revoke*, 2004 WIS. L. REV. 309, 318 (2004) [hereinafter Knapp, *Offer*]; Richard E. Speidel, *Afterword: The Shifting Domain of Contract*, 90 NW. U. L. REV. 254, 260 (1995) [hereinafter Speidel, *Domain*].
37. Knapp, *Offer*, *supra* note 36, at 317; see also Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 CALIF. L. REV. 1743, 1749, 1756–60 (2000) [hereinafter Eisenberg, *Dynamic*] (providing interpretation for the agreed-to contract terms); Feinman, *Theory*, *supra* note 36, at 1287 (supplying additional terms); Speidel, *Domain*, *supra* note 36, at 260–61 (supplying additional terms).
38. “Contract policing” doctrines are doctrines used by courts to police contracts against, among other things, unfairness or bargaining misbehavior in the formation process and inequality in the resulting exchange. See generally 2 E. ALLAN FARNSWORTH, CONTRACTS §§ 4.1, 4.9 (4th ed. 2004) (discussing the policing of contractual agreements).
39. Specifically, modern contract law gives expanded recognition to unconscionability, duress in the form of economic duress, and misrepresentation. See Hart, *supra* note 5, at 178 n.7. The traditional contract policing doctrines include minority, mental incapacity, duress, undue influence, and fraud. *Id.* Modern contract law continues to recognize them as well. See RESTATEMENT (SECOND) OF CONTRACTS §§ 14 (minority), 15 (mental illness or defect), 175 (duress), 177 (undue influence) (1981).
40. Feinman, *Theory*, *supra* note 36, at 1288; Robert Hillman, *The Crisis in Modern Contract Theory*, 67 TEX. L. REV. 103, 103–04 (1988) [hereinafter Hillman, *Crisis*]; Knapp, *Offer*, *supra* note 36, at 318; Blake D. Morant, *The Teachings of Dr. Martin Luther King, Jr. and Contract Theory: An Intriguing Comparison*, 50 ALA. L. REV. 63, 97 (1998) [hereinafter Morant, *MLK*]; Speidel, *Domain*, *supra* note 36, at 260–61. A traditional contract is one formed by mutual assent and consideration. See RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981).
41. Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 HARV. L. REV. 741, 750 (1982) [hereinafter Eisenberg, *Bargain*] (“[M]any contracts are made in markets that are highly imperfect.”).

inequalities.<sup>42</sup> Modern contract law assumes, however, that such problems are correctable with discrete and relatively easy-to-implement solutions.<sup>43</sup>

Many of the changes implemented by modern contract law were an attempt to give effect to norms of fairness and cooperation as supplements to,<sup>44</sup> but not replacements of, the classical norms of individual autonomy and liberty.<sup>45</sup> All of these changes remain in place today, despite the alleged shift from modern contract to neoclassical contract law in the 1990s.<sup>46</sup> For internal consistency and to avoid confusion in nomenclature, however, the article will refer to the contract law system that is being critiqued as “modern” contract law.

While there are clearly differences between classical and modern contract law, the two systems are fundamentally the same. This is true because modern contract law continues to adhere to most of the

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42. Morant, *MLK*, *supra* note 40, at 96 (“Anomalies of the marketplace included opportunism, the lack of perfect information, and bargaining inequity.”) (internal citations omitted); cf. Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 583 (1982) (recognizing the development of the decision maker to undertake a careful analysis in terms of the distributive objective and its consistency with freedom of contract); Mensch, *History*, *supra* note 35, at 47 (discussing the view that courts should assign rights where they are most valuable, mimicking the real-world, imperfect market).
  43. See *infra* Part I.B (discussing disclosure statutes).
  44. Melvin Aron Eisenberg, *The Responsive Model of Contract Law*, 36 STAN. L. REV. 1107, 1111–12 (1984) [hereinafter Eisenberg, *Responsive*]; Feinman, *Theory*, *supra* note 36, at 1287–88; Knapp, *Offer*, *supra* note 36, at 318; Blake D. Morant, *The Relevance of Race and Disparity in Discussions of Contract Law*, 31 NEW ENG. L. REV. 889, 902–03 (1997) [hereinafter Morant, *Race*].
  45. Peter Gabel & Jay Feinman, *Contract Law as Ideology*, in THE POLITICS OF LAW: A PROGRESSIVE CRITIQUE 497, 497 (David Kairys ed., 3d ed. 1998) (“The principle of personal autonomy underlying freedom of contract has been supplemented by modern principles of cooperation and fairness . . . .”); Morant, *MLK*, *supra* note 40, at 97 (“While clinging to the notion of contractual freedom and bargaining autonomy, neoclassicists appreciated some of the realities of bargaining differences.”).
  46. See Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 FORDHAM L. REV. 761, 773 (2002) [hereinafter, Knapp, *Private*]; Mooney, *New Conceptualism*, *supra* note 35, at 1133–34. In fact, the claims made in this article are probably more compelling as applied to neo-classical contract law, given that this system resurrects much of the classical formalism rejected by modern contract. See Feinman, *Un-Making*, *supra* note 35, at 16 (“Under the classical revival, formality reigns at two levels. First, the contract doctrine itself becomes more formal; ostensibly clear, rigid rules are favored over flexible standards. Second, the substance of the rules favors formality in contracting practices.”). But see KREITNER, *supra* note 34, at 7 (acknowledging that this version of contract history is contested).

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classical system's underlying assumptions, and it left the core of classical contract law, which is formation, completely intact.

To begin with, the modern contract law system,<sup>47</sup> like the classical system, still presupposes that an individual acts rationally<sup>48</sup> in a largely unregulated market.<sup>49</sup> Moreover, individual liability is still premised on voluntary agreement.<sup>50</sup> Modern contract law also retains the public–private distinction<sup>51</sup> upon which much of classical legal thought was based.<sup>52</sup> As a result, the paradigm transaction under modern contract law, as under classical contract law, is the private law transaction,<sup>53</sup> one that is framed by all of the following well-established<sup>54</sup> classical and now modern assumptions:<sup>55</sup>

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47. See Feinman, *Theory*, *supra* note 36, at 1310.
  48. See Jay M. Feinman, *Relational Contract Theory in Context*, 94 Nw. U. L. REV. 737, 739–40, 743 (2000) [hereinafter Feinman, *Relational*].
  49. See Jay M. Feinman, Book Review, 55 J. LEGAL EDUC. 287, 293 (2005) [hereinafter Feinman, Book Review].
  50. See Feinman, *Theory*, *supra* note 36, at 1287.
  51. Classical legal thought was structured around several dichotomies, the most important of which was the public–private distinction. See Feinman, *Theory*, *supra* note 36, at 1286. Within the private law sphere of the public–private dichotomy, individuals exercised rights and were free to agree on whatever contract terms they wanted. See P.S. ATIYAH, THE RISE AND FALL OF FREEDOM OF CONTRACT 403 (1979); Singer, *Realism*, *supra* note 35, at 478–79. The state ostensibly played no role in regulating the substantive terms of these private relations. See LEGAL REALISM, *supra* note 35, at 99; Singer, *Realism*, *supra* note 35, at 479. In the public sphere of government regulation, public officials exercised state power, and all state-imposed obligations, like quasi-contracts, torts, and real property, were relegated to this sphere. See Singer, *Realism*, *supra* note 35, at 478, 480–81.
  52. Mensch, *History*, *supra* note 35, at 39 ("[M]odern American legal thought continues to be premised on the distinction between private law and public law. Private law is still assumed to be *about* private actors with private rights, making private choices . . .").
  53. Jay M. Feinman, *Contract After the Fall*, 39 STAN. L. REV. 1537, 1538 (1987) (reviewing HUGH COLLINS, THE LAW OF CONTRACT (1986)) [hereinafter Feinman, *Fall*]; Mensch, *History*, *supra* note 35, at 39, 41.
  54. See, e.g., Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 MO. L. REV. 493, 495–96 (2010) ("It is, therefore, now an accepted tenet of contract law that '[f]reedom of contract prevails in an arm's-length transaction between sophisticated parties . . . and in the absence of countervailing public policy concerns there is no reason to relieve them of the consequences of their bargain.'") (alteration in original) (quoting Oppenheimer & Co. v. Oppenheim, Appel, Dixon & Co., 660 N.E.2d 415, 421 (N.Y. 1995)).
  55. All of the assumptions listed in the text were adopted by the classical legal system and retained by modern contract law. See Hart, *supra* note 5, at 189, 195–98.

- (1) A contract is a private transaction between private parties.<sup>56</sup>
- (2) Parties bargain at arm's length, meaning they are most likely strangers to one another.<sup>57</sup>
- (3) Individuals are rational actors in the marketplace.<sup>58</sup>
- (4) Contracts result from voluntary and informed choice.<sup>59</sup>

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56. ATIYAH, *supra* note 51, at 408 ("The autonomy of the free choice of private parties to make their own contracts on their own terms was the central feature of classical contract law."); Gillian K. Hadfield, *An Expressive Theory of Contract: From Feminist Dilemmas to a Reconceptualization of Rational Choice in Contract Law*, 146 U. PA. L. REV. 1235, 1261 (1998) ("Conventional contract logic views contract law as a realm of purely private ordering in which individuals are free to choose the structure of their relationships without interference. In this view, law does not judge the formation, performance, or breach of a contract on the basis of external juristic values; law acts only as a surrogate for the values created by the parties themselves."); *see also* Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 YALE L.J. 997, 1014 (1985) ("[O]ur principal vision of contract law is still one of a neutral facilitator of private volition. We understand that contract law is concerned at the periphery with the imposition of social duties . . . . But we conceive the central arena to be an unproblematic enforcement of obligations voluntarily undertaken. . . . Although we concede that the law of contract is the result of public decisions about what agreements to enforce, we insist that the overarching public decision is to respect and enforce private intention.").
  57. *See* ATIYAH, *supra* note 51, at 402–03 ("The model of contract theory which implicitly underlay the classical law of contract . . . was thus the model of the market. Essentially this model is based on the following principal features. First, the parties deal with each other 'at arm's length' . . . ; this carries the notion that each relies on his own skill and judgment, and that neither owes any fiduciary obligation to the other."); Melvin A. Eisenberg, *Why There Is No Law of Relational Contracts*, 94 NW. U. L. REV. 805, 808 (2000) [*hereinafter* Eisenberg, *Relational*] ("[C]lassical contract law was implicitly based on a paradigm of bargains made between strangers transacting in a perfect market.").
  58. Eisenberg, *Relational*, *supra* note 57, at 808 ("[C]lassical contract law was based on a rational-actor model of psychology, under which actors who make decisions in the face of uncertainty rationally maximize their subjective expected utility, with all future benefits and costs discounted to present value. In particular, the rules of classical contract law were implicitly based on the assumptions that actors are fully knowledgeable, know the law, and act rationally to further their economic self-interest."); Jay M. Feinman, *Critical Approaches to Contract Law*, 30 UCLA L. REV. 829, 832 (1983) [*hereinafter* Feinman, *Critical*] (individuals acted in their own self-interest); *see also* ATIYAH, *supra* note 51, at 403.
  59. Hadfield, *supra* note 56, at 1247 (1998) ("Contract law proceeds from the premise that obligation is established by the existence of voluntary and informed choice to enter into a contract."); *see also* ATIYAH, *supra* note 51, at 403 ("[The fourth principle of classical contract law is that] the deal is finally struck when the parties agree, or

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(5) Contract law is the law of the market.<sup>60</sup> Markets are neutral and impartial, primarily self-regulating, and largely outside of state control, but they do contain imperfections in the form of information asymmetries and bargaining inequalities.<sup>61</sup> Such imperfections, however, can be fixed with minimal interference from the state, thereby preserving the integrity of the market.<sup>62</sup>

(6) The state's role is neutral and minimal.<sup>63</sup>

In addition, and significantly, modern and classical contract law are fundamentally the same because modern contract law left the core

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indicate their agreement. . . . The agreement must be made ‘freely’ and ‘without pressure’ but these concepts are very narrowly interpreted, for they must not conflict with the rule of the market place . . . .”); Singer, *Realism*, *supra* note 35, at 479 (arguing that the “[c]lassical theorists considered three principles to be central to a free contract system[,]” one of which was the principle that a party could not be forced to contract against her will).

60. See ATIYAH, *supra* note 51, at 402 (“The emphasis on contract law as the law of the market was, in England at least, well established by 1870, although in America it may have been a later development.”); Singer, *Realism*, *supra* note 35, at 477–82. See generally AMY DRU STANLEY, FROM BONDAGE TO CONTRACT 2, 13, 59 (1998) (establishing that market theory of contract is a post-emancipation phenomenon); Morton J. Horwitz, *The Historical Foundations of Modern Contract Law*, 87 HARV. L. REV. 917, 936–52 (1974).
61. Morant, *MLK*, *supra* note 40, at 95 (“Anomalies of the marketplace included opportunism, the lack of perfect information, and bargaining inequity.”) (footnotes omitted).
62. According to Jay Feinman, there is an “ideology of the market” still regnant in legal education, politics, government, and social thought generally. He writes:

This ideology presents the market as the primary form of social organization, as an empirical fact and a desirable state of affairs. The market effectively enables individuals to achieve their life projects while maximizing social welfare as a whole. It arises and proceeds through a spontaneous order, obviating centralized planning or significant government intervention. All of these virtues require no more than modest correction at the margins, and the job of the law is to maintain the conditions of the market, notably through establishing ground rules of property and contract, providing legal institutions and mechanisms to facilitate market transactions, and maintaining social order.

Feinman, Book Review, *supra* note 49, at 293.

63. *The Critique of the Public/Private Distinction*, in AMERICAN LEGAL REALISM, *supra* note 35, at 98, 99; see also Dalton, *supra* note 56, at 1012–13; Singer, *Realism*, *supra* note 35, at 479–80, 481.

of classical contract law, which is formation, completely intact.<sup>64</sup> Mutual assent and consideration remain the only two elements necessary to form a contract.<sup>65</sup> Indeed, modern contract law actually strengthens the core (formation) because it makes it easier to form a contract.<sup>66</sup> Specifically, modern contract law makes it particularly easy to establish mutual assent,<sup>67</sup> and the existence and adequacy of consideration is seldom, if ever, questioned in a market-based transaction.<sup>68</sup>

Thus, modern contract law, like classical contract before it, creates a “presumption of contract validity”<sup>69</sup> upon formation of a traditional contract via mutual assent and consideration.<sup>70</sup> In other words, upon formation, the law will presume that a valid contract exists.<sup>71</sup> Significantly, the presumption of contract validity is very difficult to rebut under both the classical and modern systems, because of what I have called elsewhere the “process problem.”<sup>72</sup> Briefly, the process problem makes rebutting the presumption of contract validity especially difficult because (1) the burden of proving that a contract is unenforceable<sup>73</sup> for any reason is on the party challenging the contract or defending against a breach of contract claim;<sup>74</sup> (2) *all* of

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64. See generally Hart, *supra* note 5, at Part III.B.
  65. See RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981) (“[T]he formation of a contract requires a bargain in which there is a manifestation of mutual assent to the exchange and a consideration.”); Morant, *MLK*, *supra* note 40, at 93 (“A basic tenet of traditional, classic contract theory requires that parties steadfastly obey the rules of bargain formation in order to have binding agreements. Those whose agreements manifest mutual assent and contain consideration may expect the enforcement of their resultant agreements, barring some impediment.”) (footnotes omitted).
  66. See Hart, *supra* note 5, at Part III.B.3.
  67. *Id.* at 202–10.
  68. See 2 FARNSWORTH, *supra* note 38, § 2.2, at 48; Hart, *supra* note 5, at 205. In fact, consideration is often irrelevant in a business context because contract law will find a binding contract even in the absence of it. See, e.g., U.C.C. § 2-205 (2003) (creating an option contract without requiring consideration); U.C.C. § 2-209(1) (2003) (making a modification under Article 2 binding without consideration); RESTATEMENT (SECOND) OF CONTRACTS § 89 (a), (c) (1981) (containing exceptions to the pre-existing duty rule that validate modifications obtained without consideration).
  69. See generally Hart, *supra* note 5, at Part III.B.4.
  70. A traditional contract is one formed via mutual assent and consideration. See RESTATEMENT (SECOND) OF CONTRACTS § 17(1) (1981).
  71. Hart, *supra* note 5, at 206.
  72. See *id.* at 210–15.
  73. “Unenforceable,” as used here, refers to anything that gets someone out of the contract, whether by rescission, discharge of performance obligation, unenforceability of the contract, etc.
  74. Hart, *supra* note 5, at 207, 212–15; see also Stone v. Walsh, No. MMX085005292S, 2010 WL 4944629, at \*11 (Conn. Super. Ct. Nov. 19, 2010) (noting that the burden of

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the other contract doctrines that someone challenging or defending against the contract might use, including, but not limited to, contract interpretation,<sup>75</sup> the contract policing doctrines<sup>76</sup> and defenses to performance,<sup>77</sup> are literally outside the core—to use them one must assume that an otherwise valid contract has been formed;<sup>78</sup> and (3) practical realities, like the expense of litigation,<sup>79</sup> the extensive use of

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proof for misrepresentation claim is on plaintiff who raised it and the burden of proof for defense of waiver is on defendant); Olive v. McNeal, 47 So. 3d 735, 739–40 (Miss. Ct. App. 2010) (“The party seeking reformation of a deed on a mistake theory bears the burden of proof beyond a reasonable doubt.”); Grice Eng’g, Inc. v. Innovations Eng’g, Inc., No. 2009AP2757, 2010 WL 3768107, at \*6 (Wis. Ct. App. Sept. 23, 2010) (“The burden of proving unconscionability is on the party alleging unconscionability.”).

75. In contract interpretation, the contracting parties are now disputing what they meant when they manifested their assent to the contract. The court is called upon to decide which party's meaning prevails through the process of interpretation. 2 FARNSWORTH, *supra* note 38, § 7.7. If the parties did not think they were bound by a contract and, hence, subject to liability for failing to perform, common sense says that no one would be asking a court to determine whose meaning prevails, i.e., the interpretive question posed by RESTATEMENT (SECOND) OF CONTRACTS § 201. The existence of a valid contract must therefore be presumed. *See also* Eugene F. Mooney, *Old Kontract Principles and Karl's New Kode: An Essay on the Jurisprudence of Our New Commercial Law*, 11 VILL. L. REV. 213, 246 (1966) (“The parol evidence rule, plain meaning rule and traditional maxims of construction employed by courts to interpret contracts all reinforce the notion of a rigorous doctrine of *pacta sunt servanda* [agreements should be kept].”). *See generally* Hart, *supra* note 5, at 200–01 n.147.
76. Specifically, if established on the facts, all the contract policing doctrines, such as duress and misrepresentation, either result in a voidable contract or make a contract unenforceable in whole or in part. *See, e.g.*, RESTATEMENT (SECOND) OF CONTRACTS §§ 164 (misrepresentation—voidable contract), 175 (duress—voidable contract), 177 (undue influence—voidable contract), 208 (unconscionability—unenforceable contract) (1981). Clearly, a contract has to exist in the first instance to thereafter be made voidable or unenforceable. *See* Hart, *supra* note 5, at 201 n.149.
77. Defenses to performance would include but not be limited to claims of mistake (mutual and unilateral), as well as impracticability of performance and frustration of purpose. By definition, these doctrines only apply to contracts already in existence. *See* RESTATEMENT (SECOND) OF CONTRACTS § 152 (1981) (“Where a mistake of both parties [exists] *at the time a contract was made* as to a basic assumption on which *the contract was made . . .*, the contract is voidable . . .”) (emphasis added); *id.* § 153 (unilateral mistake); *id.* § 261 (impracticability of performance—“[w]here, *after a contract is made*, a party's performance is made impracticable . . . , his duty to render that performance is discharged . . .”) (emphasis added); *id.* § 265 (frustration of purpose—containing similar language to § 261); *see* Hart, *supra* note 5, at 201 n.150.
78. Hart, *supra* note 5, Part III.B.2.
79. Lawsuits are very expensive. *See* Scott Baker & Kimberly D. Krawiec, *Incomplete Contracts in a Complete Contract World*, 33 FLA. ST. U. L. REV. 725, 737 (2006) (“Litigation costs, specifically attorney fees, make it expensive to pursue a contract

certain boilerplate contract clauses,<sup>80</sup> and the fact that courts rarely let parties out of their contracts, regardless of the legal excuse advanced,<sup>81</sup> make a successful rebuttal of the presumption of contract validity highly unlikely.<sup>82</sup>

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claim.”); Hart, *supra* note 5, at 212 n.209; F. Andrew Hessick, *Standing, Injury in Fact, and Private Rights*, 93 CORNELL L. REV. 275, 326 (2008) (“Lawsuits are expensive and time consuming, and therefore most individuals will not bring a suit that has little or no potential for a damages award.”); Robert Sprague & Karen L. Page, *The Private Securities Litigation Reform Act and the Entrepreneur: Protecting Naïve Issuers from Sophisticated Investors*, 8 WYO. L. REV. 167, 175 (2008) (“Filing a lawsuit initiates a long, complex, and expensive process.”).

80. These clauses include, for example, mandatory arbitration provisions, forum selection clauses, and choice of law clauses, all of which have been found valid by the courts. See, e.g., Green Tree Fin. Corp.-Ala. v. Randolph, 531 U.S. 79, 89–92 (2000) (arbitration clause); Allied-Bruce Terminix Cos., Inc. v. Dobson, 513 U.S. 265, 268 (1995) (arbitration clause); Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585, 595–97 (1991) (forum selection clause); Gilmer v. Interstate/Johnson Lane Corp., 500 U.S. 20, 26–35 (1991) (arbitration clause); Dean Witter Reynolds, Inc. v. Byrd, 470 U.S. 213, 223–24 (1985) (arbitration clause); M/S Bremen v. Zapata Off-Shore Co., 407 U.S. 1, 2 (1972) (forum selection clause); Johnson v. Ventra Grp., Inc., 191 F.3d 732, 741 (6th Cir. 1999) (choice of law clause); Wang Labs., Inc. v. Kagan, 990 F.2d 1126, 1128–29 (9th Cir. 1993) (choice of law clause); Milanovich v. Costa Crociere, S.p.A., 954 F.2d 763, 769 (D.C. Cir. 1992) (choice of law clause); Interfirst Bank Clifton v. Fernandez, 853 F.2d 292, 293–95 (5th Cir. 1988) (choice of law clause); Hart, *supra* note 5, at 213 n.212.

81. According to Professor Robert Lloyd:

We spend so much time on the unusual cases where courts find a way to let people out of their bad deals that students begin to think these cases are the norm. Students are amazed when I tell them that it is virtually unheard of for a sophisticated party, or even a party only moderately sophisticated, to prevail on an unconscionability argument. Yes, you can win an unconscionability case if your client is poor and uneducated, and if the other party is a sleazy organization that preys on poor people, and if you’re able to afford an appeal, and if you get Skelly Wright on the bench. But absent these circumstances, the client is going to be stuck with the documents she signs.

Robert M. Lloyd, *Making Contracts Relevant: Thirteen Lessons for the First-Year Contracts Course*, 36 ARIZ. ST. L.J. 257, 267 (2004) (footnote omitted); see also E. Allan Farnsworth, *Developments in Contract Law During the 1980’s: The Top Ten*, 41 CASE W. RES. L. REV. 203, 225 (1990) (“[C]ontinued expansion of unconscionability and related doctrines did not occur in the 1980s as expected.”); Hart, *supra* note 5, at 214–15 n.216; Robert A. Hillman, *Contract Excuse and Bankruptcy Discharge*, 43 STAN. L. REV. 99, 99 (1990) (“Notwithstanding academic writing that reports or urges expansion of the grounds of excuse, courts actually remain extremely reluctant to release parties from their obligations.”); Knapp, *Private*, *supra* note 46, at 775 (noting that the burden of persuasion with respect to unconscionability claims “is at best difficult, [and] at worst literally impossible to satisfy”); Morant, *MLK*, *supra* note 40, at 110 (“The existence of . . . duress,

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The practical consequence of the presumption of contract validity under either contract law system, therefore, is that a contract formed via mutual assent and consideration will usually be binding, which is the first component of a “binding contract,” and all of its terms (reasonable *and* unreasonable) will most likely be enforceable in court.<sup>83</sup> Enforceability, of course, represents the second component

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unconscionability, and undue influence cannot, by themselves, sufficiently accommodate marketplace inequities. The very dearth of cases where individuals are successful in obtaining relief through those devices substantiates this point. This result is compounded by the heavy burden of proof placed upon the claimant of such relief.” (footnotes omitted).

82. See generally Hart, *supra* note 5, at 212–15.
83. There are “efficient terms” and “fair use” objections to the claim made in the text that all the terms of a contract, including the unreasonable ones, would probably be valid and enforceable. The efficient terms objection is that terms in standard forms are efficient, even if most people do not read them, either because (1) a profit-maximizing business will offer optimal terms under the assumption that the preferences of the marginal consumer are the same as those of the average consumer, *see Florencia Marotta-Wurgler, Competition and the Quality of Standard Form Contracts: The Case of Software License Agreements*, 5 J. EMPIRICAL LEGAL STUD. 447, 449 (2008) [hereinafter, Marotta-Wurgler, *Competition*] (discussing the argument of A. Michael Spence, *Monopoly, Quality, and Regulation*, 6:2 BELL J. ECON. 417, 417–29 (1975)); or (2) there is a subset of informed buyers who do read the terms of standard forms and are, therefore, willing to pay more for products with better standard terms. Because a business cannot discriminate between reading and non-reading buyers, the self-interested business will offer better terms to all buyers. Marotta-Wurgler, *Competition*, *supra* at 454 (discussing the argument of 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 (1979)).

Two brief responses to the efficient terms objection are in order. To begin with, whether “efficient” is all that can or should be expected from terms in standard form contracts is debatable. Cf Michael B. Dorff & Kimberly Kessler Ferzan, *Is There a Method to the Madness? Why Creative and Counterintuitive Proposals Are Counterproductive*, in THEORETICAL FOUNDATIONS OF LAW AND ECONOMICS 21, 22 (Mark D. White ed., 2009). In addition, initial empirical research by Professor Florencia Marotta-Wurgler, makes me very skeptical of the efficient terms objection. Marotta-Wurgler’s research finds that standard terms in software license agreements are biased in favor of sellers (the party that drafted the forms). Marotta-Wurgler, *Competition*, *supra* at 459–63. Much more empirical work needs to be done to decide this particular objection, one way or the other.

Even assuming there are unreasonable terms in a contract, the fair use objection questions whether the stronger, and presumably drafting, party will actually enforce them, given fairness and reputational norms that would constrain such behavior. Clayton P. Gillette, *Rolling Contracts as an Agency Problem*, 2004 WIS. L. REV. 679, 703 (2004) (arguing that the “holder of an entitlement . . . may unilaterally waive or underenforce that entitlement[.]”); *id.* at 708; *see also id.* at 707 (the reputational norm); Christine Jolls, Cass R. Sunstein & Richard Thaler, *A Behavioral Approach to*

of a binding contract, because enforceability overtly implicates the state.<sup>84</sup> Specifically, the state will use its sovereign power (i.e., its “judges, sheriffs, and other state agents”) on behalf of one party to enforce the rights expressed in that contract against the resisting party.<sup>85</sup> Thus, modern contract law, just like classical contract law, makes contracts binding.

The implications for the parties to the contract cannot be overlooked or overstated. Because contracts are made binding in the ways described above, the party that gets to dictate or impose terms during contract formation will usually get to keep and use those terms in the event of any subsequent contract dispute.<sup>86</sup> Clearly, the party that has the ability to impose terms during contract formation is the party with the bargaining power to do so. Hence, formation is the core, because this is where the stronger contracting party’s power

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*Law and Economics*, 50 STAN. L. REV. 1471, 1513–15 (1998) (the fairness norm). This objection also poses an empirical question, and I am unaware of any study that addresses it. Notwithstanding the lack of empirical evidence, I am very skeptical of this objection as well. The extent of market constraints placed on sellers by reputational concerns is contested at best and is arguably rather minimal. See Richard Craswell, *Interpreting Deceptive Advertising*, 65 B.U. L. REV. 657, 723–24 (1985); Peter V. Letsou, *The Political Economy of Consumer Credit Regulation*, 44 EMORY L.J. 587, 595 & n.21 (1995); Stephen J. Lubben, *Railroad Receiverships and Modern Bankruptcy Theory*, 89 CORNELL L. REV. 1420, n.10 (2004); Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901, 907 & n.23 (1986). Finally, institutional constraints could undercut the fairness norms. Briefly, the people responsible for enforcement decisions within a company (e.g., legal counsel) will likely be different from the people who initially sold the product or service (e.g., the sales department). Different considerations, therefore, would motivate the enforcement decision.

Finally, both the efficient terms and fair use objections discount too steeply (i) the potential *in terrorem* effect the existence of unreasonable terms in the contract could have on the weaker party if a dispute were to arise during performance of the contract; (ii) the bargaining advantage such terms provide the stronger party in any settlement negotiations; and, ultimately, (iii) the fact that such terms would be asserted by the stronger party in any ensuing litigation, unless the client agreed otherwise. It is difficult to envision the litigation scenario in which a client would instruct its attorneys not to use any terms in the contract that would benefit it in the litigation. Absent the client’s consent to refrain from using such terms, the attorney(s) for the stronger party could be violating ethical rules by failing to assert claims or defenses based on unreasonable terms in the contract. See, e.g., MODEL RULES OF PROF’L CONDUCT PREAMBLE ¶¶ 2, 19, R. 1.1, 1.3 (2007); Hart, *supra* note 5, at 216.

84. See Hart, *supra* note 5, at 212–15.

85. Cohen, *Contract*, *supra* note 32, at 585–86; see also Singer, *Realism*, *supra* note 35, at 483–85.

86. See generally Hart, *supra* note 5, at 216–17.

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becomes embedded and largely immunized from effective challenge.<sup>87</sup>

Finally, in addition to its core, underlying assumptions and end result, there is one other aspect of the modern contract law system that must be taken into account. Perhaps not surprisingly, the framework for modern contract law is designed to be self-legitimizing.<sup>88</sup> This point is illustrated by the way in which the system approaches problems. Specifically, because the modern contract law system is premised on the assumptions discussed above, it means that problems within contract law are acknowledged only if they contradict one or more of those assumptions.<sup>89</sup> From there, a remedy is adopted, which may or may not actually work, but is one that will nevertheless reaffirm and thereby relegate the assumption(s) originally contradicted.<sup>90</sup>

For example, modern contract law assumes that unequal bargaining power exists,<sup>91</sup> but in an unproblematic way.<sup>92</sup> Unequal bargaining power, however, presents significant problems for modern contract law when it is used to procure a one-sided (or bad) bargain.<sup>93</sup> It also presents a problem when it takes the form of information

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87. *Id.*

88. That the framework is self-legitimizing is not surprising, because any system that purports to be comprehensive, like modern contract law claims to be, would have to be able to address problems that come up in ways that do not end up undermining the entire system. Cf. Feinman, *Critical*, *supra* note 58, at 832 (demonstrating how modern contract law attempted to solve the problems of classical contract law but in a way that did not completely undermine the former system); Feinman, *Theory*, *supra* note 36 (documenting the ways in which modern contract law addressed various critiques leveled against the system); Gabel & Feinman, *supra* note 45 (exposing the legitimizing function contract law serves in society in general). My concern, therefore, is not that the framework is self-legitimizing but rather in discovering and exposing what else the framework legitimizes.

89. See Kennedy, *supra* note 42, at 576.

90. Much of the discussion in the text is based on Duncan Kennedy's discussion of unequal bargaining power. See generally *id.* at 620–24.

91. It is a form of market imperfection. See *supra* text accompanying notes 1–45 (modern system acknowledging market imperfections); Kennedy, *supra* note 42, at 577; Morant, *MLK*, *supra* note 40, at 96.

92. Barnhizer, *Inequality*, *supra* note 15, at 144 “The legal doctrine of inequality of bargaining power occupies a strange place in contract law. As an explicitly acknowledged legal concept, inequality of bargaining power is seemingly of little moment. . . . [I]nquality of bargaining power alone is not a sufficient justification for judicial intervention into contract disputes.” *Id.* It is simply not explicitly discussed.

93. See generally Hart, *supra* note 5.

asymmetry<sup>94</sup> (i.e., when one party is in possession of relevant information that is deemed necessary for the other party to make an informed decision about whether to enter into a contract).<sup>95</sup>

To correct the problems of bad bargains and information asymmetry, modern contract law relies upon its contract policing doctrines and disclosure statutes, respectively.<sup>96</sup> Unfortunately, these solutions do not work very well.<sup>97</sup> But by providing solutions, the modern contract law system is able to show that the problem of unequal bargaining power merely requires “reform of exceptional cases and intelligent response to abuses.”<sup>98</sup> In other words, because problems created by unequal bargaining power can be remedied with discrete and relatively easy-to-implement solutions, unequal bargaining power is shown to be the exception,<sup>99</sup> not the norm.<sup>100</sup> And because it can essentially treat unequal bargaining power as the exception, modern contract law is able to reaffirm and re-legitimize its assumption that unequal bargaining power exists but only at the

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94. See Daniel D. Barnhizer, *Bargaining Power in Contract Theory*, in VISIONS OF CONTRACT THEORY 85, 93–94 (Larry A. Dimatteo, Robert A. Prentice, Blake D. Morant, and Daniel D. Barnhizer 2007) [hereinafter, Barnhizer, *Bargaining Power*] (“Legal and nonlegal observers recognize qualities such as superior information . . . as sources of power.”); Omri Ben-Shahar & Carl. E. Schneider, *The Failure of Mandated Disclosure*, 159 U. PA. L. REV. 647, 649 (2011) (“[The purpose of mandatory disclosure is] to keep the discloser from abusing its superior position.”).
  95. Cf. Barnhizer, *Inequality*, *supra* note 15, at 147 (“[F]raud, deceit or misrepresentation may be analyzed as an inequality of bargaining power generated by a monopoly on truthful information held by one party to a transaction.”).
  96. See Hart, *supra* note 5 (documenting that the expanded contract policing doctrines—unconscionability, economic duress, and misrepresentation—were modern contract’s solution to the unequal bargaining power that produces a bad bargain problem); *infra* Part I.B (discussing purpose of disclosure statutes).
  97. See Hart, *supra* note 5 (explaining in detail why contract policing doctrines do not adequately address the unequal bargaining power that produces a bad bargain problem); *infra* Part III.B (explaining why disclosure statutes do not work).
  98. Kennedy, *supra* note 42, at 620.
  99. Robert W. Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 WIS. L. REV. 565, 571 (1985) (“Modern contract scholars tend to see . . . relations of domination as aberrational situations, which, for good or evil . . . contract law has evolved various curative doctrines to police. In other words, there is not that much of a problem, and contract law can take care of what problem there is.”).
  100. Kennedy, *supra* note 42, at 621 (“In this context, the doctrine of unequal bargaining power has the appeal that it presupposes that most of the time there is equal bargaining power, so that freedom of contract is the appropriate norm. It is an exceptional doctrine, unthreatening to basic arrangements, however critical of particular cases.”).

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margins, as an exception that proves the rule and supports the general paradigm of equality.<sup>101</sup>

By approaching problems in this way, specifically by defining perceived problems in terms of its assumptions and then providing solutions consistent with these assumptions, the modern contract law system is not only able to stave off criticism of the system as a whole, it can also show that its framework remains intact. Both of these by-products are integral to the continuing operation of the modern contract law system. Indeed, this is what enables the modern contract law system to be self-legitimizing.

### B. Disclosure Statutes as a Modern Contract Law Remedial Tool

Disclosure statutes play an important role in the modern contract law system. They are certainly not new. They have been in use in the United States for decades<sup>102</sup> and a lot has been written about them.<sup>103</sup> At their most basic, disclosure statutes are statutes that

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101. A more concrete example of this phenomenon is laid out by Professor John Dawson in his 1947 article, *Economic Duress—An Essay in Perspective*, 45 Mich. L. Rev. 253 (1947). Dawson wrote:

[A]n extreme disproportion in values in a bargain transaction requires explanation, and the explanation can usually be found in some misplaced reliance on the opposite party's good faith, some misleading partial disclosure, or some extreme inequality of the parties in knowledge, experience, or economic resources. If inequality in values is thus traced to its source in the conditions or the relations of the parties, the grant of judicial remedies seems no longer to endanger the economic foundations of an individualistic society. On the contrary, the function of judicial remedies [like economic duress, misrepresentation and unconscionability] becomes a policing function, the detection and correction of those factors which disturb and disrupt the "market."

*Id.* at 281.

102. See, e.g., William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 Wis. L. REV. 400, 400 (1973) [hereinafter, Whitford, *Disclosure*] ("One of the oldest and most prevalent methods of regulating consumer transactions has been to require the seller to disclose to his consumer buyer various types of information about their contractual transaction.") (footnote omitted); 15 U.S.C. §§ 1601–1615, 1631–1649, 1661, 1667(f) (2000 & Supp. III 2004) (implemented by the Federal Reserve Board via Regulation Z, 12 C.F.R. § 226.1 (2005)); Magnuson-Moss Warranty Federal Trade Commission Improvement Act, Pub. L. No. 93-637, §§ 101–112, 88 Stat. 2183 (1975) (codified at 15 U.S.C. §§ 2301–2312 (2000)).

103. See, e.g., Jo Carrillo, *Dangerous Loans: Consumer Challenges to Adjustable Rate Mortgages*, 5 BERKELEY BUS. L.J. 1, 31, 33–43 (2008); Matthew A. Edwards, *The Law, Marketing and Behavioral Economics of Consumer Rebates*, 12 STAN. J.L. BUS.

require certain pieces of information to be disclosed by one party to the other.<sup>104</sup> They exist to a large extent in the consumer protection arena (e.g., the Truth in Lending Act<sup>105</sup> and the Magnuson-Moss Warranty Act) but are not limited to this area.<sup>106</sup> For example, several provisions of Article 2 of the Uniform Commercial Code also require disclosure, namely the provisions on good faith,<sup>107</sup>

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& FIN. 362, 407–13 (2007); The Honorable Sheldon Gardner & Robert Kuehl, *Acquiring an Historical Understanding of Duties to Disclose, Fraud, and Warranties*, 104 COM. L.J. 168, 181–82 (1999); Alex M. Johnson, Jr., *An Economic Analysis of the Duty to Disclose Information: Lessons Learned from the Caveat Emptor Doctrine*, 45 SAN DIEGO L. REV. 79, 119 (2008); Christopher L. Peterson, *Usury Law, Payday Loans, and Statutory Sleight of Hand: Salience Distortion in American Credit Pricing Limits*, 92 MINN. L. REV. 1110, 1129–35 (2008); Alex Polonsky, “Tanks for the Memories:” *Abandoning Caveat Emptor for the Transfers of Residential Property Contaminated with Petroleum from Leaking Underground Storage Tanks*, 22 VT. L. REV. 979, 1003 (1998); Kathleen McNamara Tomcho, *Commercial Real Estate Buyer Beware: Sellers May Have the Right to Remain Silent*, 70 S. CAL. L. Rev. 1571, 1572, 1589–90 (1997); Jessica P. Wilde, *Violations of Zoning Ordinances, the Covenant Against Encumbrances, and Marketability of Title: How Purchasers Can Be Better Protected*, 23 TOURO L. REV. 199, 228–32, 243–46 (2007); Willis, *supra* note 26; Whitford, *Disclosure*, *supra* note 102.

104. See Ben-Shahar & Schneider, *supra* note 94, at 649.
105. Truth in Lending Act, 15 U.S.C. §§ 1601–1615, 1631–1649, 1661, 1667(f) (2000 & Supp. III 2004) (implemented by the Federal Reserve Board via Regulation Z, 12 C.F.R. § 226 (2005)).
106. Mandatory disclosure is certainly not limited to contract law. Torts and criminal law, for example, both have mandatory disclosure rules. In tort law, mandatory disclosure takes the form of the informed consent doctrine. In criminal law, the Miranda warnings constitute a mandatory disclosure rule. See Ben-Shahar & Schneider, *supra* note 94, at 661–62 (informed consent and Miranda warnings, respectively). What all of these mandatory disclosures have in common is that they require certain disclosures to be made that will enable an individual to make an informed decision about her contracts, health care, or constitutional rights, for example. *Id.* at 3–15.
107. Robert S. Summers, writing in 1968, discussed good faith in terms of an “excluder” analysis, meaning that good faith was to be defined, or would “take[] on specific and variant meanings by way of contrast with the specific and variant forms of bad faith which judges decide to prohibit.” Robert S. Summers, “Good Faith” in *General Contract Law and the Sales Provisions of the Uniform Commercial Code*, 54 VA. L. REV. 195, 202 (1968). Summers argued that good faith included the duty to disclose material facts under certain circumstances. *Id.* at 203; see also Emily M.S. Houh, *Critical Interventions: Toward an Expansive Equality Approach to the Doctrine of Good Faith in Contract Law*, 88 CORNELL L. REV. 1025, 1028 (2003). In discussing Summers’s work, Houh writes, “because courts define the withholding of relevant information in the contracting process as bad faith, a contracting party must disclose all such information in order to satisfy the implied obligation of good faith.” *Id.* See generally U.C.C. §§ 1-201(b)(20), 1-304, 2-103(1)(b) (2001).

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unconscionability,<sup>108</sup> and warranty,<sup>109</sup> and they apply to merchants as well as consumers.<sup>110</sup>

Several related reasons for disclosure statutes are advanced by courts and scholars. Disclosure statutes supposedly limit the advantage of the party with superior bargaining power,<sup>111</sup> allow the market to work,<sup>112</sup> and allow for the possibility of individual choice.<sup>113</sup> By putting all of this together, it appears that the main

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108. See U.C.C § 2-302 (2001); Whitford, *Disclosure*, *supra* note 102, at 401 (citing unconscionability as the example, Whitford notes that “[t]he Uniform Commercial Code, in what few efforts it makes to regulate consumer transactions, generally stresses disclosure regulation”). See generally Arthur Allen Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 U. PA. L. REV. 485, 498 (1967).
  109. See U.C.C §§ 2-313 (express warranties), 2-314 (the implied warranty of merchantability), 2-316 (disclaimer of warranties) (2001); Summers, *supra* note 107, at 229–30 (arguing that good faith may require sellers to disclose information to their buyers under their obligation to sell “merchantable goods” per the implied warranty of merchantability).
  110. Nothing in the text or comments of any of the cited Article 2 provisions limits their application to consumer transactions.
  111. Cf. JOHN D. CALAMARI & JOSEPH M. PERILLO, THE LAW OF CONTRACTS § 10.1, at 430 (3d ed. 1987) (discussing government controls generally).
  112. Scott J. Burnham, *The Regulation of Rent-To-Own Transactions*, 3 LOY. CONSUMER L. REV. 40, 41 (1991) (“The theory behind disclosure is that it allows the market to work. Theoretically, consumers who know what interest rates are offered by various sellers will ‘shop around’ for favorable credit terms just as they shop around for the price of the goods themselves.”); Michael J. Wisdom, *An Empirical Study of the Magnuson-Moss Warranty Act*, 31 STAN. L. REV. 1117, 1117 (1979) (“The stated purposes of the [Magnuson-Moss Warranty] Act were to improve the clarity and accuracy of information contained in consumer product warranties and to increase competition in the marketing of consumer products.”). See generally Florencia Marotta-Wurgler, *Does Disclosure Matter?* 1–3 (N.Y.U. Ctr. for Law, Econ. & Org., Working Paper No. 10-54, 2010), available at <http://ssrn.com/abstract=1713860> [hereinafter Marotta-Wurgler, *Disclosure*] (reviewing several disclosure initiatives whose purpose was to improve market functions).
  113. Cf. W. Kip Viscusi, *Individual Rationality, Hazard Warnings, and the Foundations of Tort Law*, 48 RUTGERS L. REV. 625, 629 (1996) (arguing, in essence, that hazard warnings, which are clearly a type of disclosure, are attractive because they allow for the possibility of individual choice). “The flexibility of warnings enables those who are unwilling to incur risks to take appropriate precautions or to avoid the risky activity, and also enables individuals who are willing to engage in the risky behavior to do so.” *Id.*; see also Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 704–05 (1999) (discussing the Viscusi article). Cf. LOUIS KAPLOW & STEVEN SHAVELL, MICROECONOMICS 40 (2004) (“[W]hen government provides information about products to consumers, individuals can decide on the basis of their desires after considering the information whether to purchase those products. Hence, purchase decisions tend to be socially desirable.”). The same argument would seem to apply

reason for adopting a disclosure regime is to correct bargaining imbalances and market failure, primarily in the form of information asymmetries, thereby improving the quality of the contractual decisions made.<sup>114</sup>

Thus, despite being creatures of statute, disclosure statutes are a quintessential modern contract law remedial tool for two reasons. First, they incorporate the norms of both the classical and modern systems.<sup>115</sup> They preserve individual autonomy, the core value of the classical legal system,<sup>116</sup> while simultaneously deploying the modern norms of fairness and cooperation.<sup>117</sup> More specifically, disclosure statutes protect the parties' freedom of contract—the classical autonomy value<sup>118</sup>—by continuing to allow the parties to contract for essentially whatever they want. At the same time, they marginally limit the parties' power to contract by mandating disclosure of certain relevant information, which represents a deployment of the modern norms of fairness and cooperation.<sup>119</sup>

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when a party, as opposed to the government and pursuant to a disclosure requirement, provides the information to the consumer.

114. Larry T. Garvin, *Small Business and the False Dichotomies of Contract Law*, 40 WAKE FOREST L. REV. 295, 324 (2005); John Roddy, *Reversing Field: Is There a Trend Toward Abrogating Truth in Lending?*, 1998 PRAC. LAW INST. COMM. LAW AND PRAC. COURSE HANDBOOK SERIES 637, 642, available at 772 PLI/Comm 637 (West 1998) ("The purpose of TILA is to enable consumers to intelligently shop for credit."); Whitford, *Disclosure*, *supra* note 102, at 403 ("[P]roponents of disclosure statutes typically presume that conspicuous and comprehensible disclosure will cause many consumers to change their buying behavior so as either to refrain from buying particular products or services that they otherwise would have bought, or to shop more carefully among competing products or services."). Cf. Edward L. Rubin, *Types of Contracts, Interventions of Law*, 45 WAYNE L. REV. 1903, 1910–11 (2000) (discussing information asymmetry as a particular type of market failure).
115. Recall that the modern contract law system supplements, but does not replace, the classical norms of individual autonomy and liberty with norms of fairness and cooperation. *See supra* notes 44–46.
116. *See supra* text accompanying note 45.
117. *See supra* text accompanying note 44.
118. Ben-Shahar & Schneider, *supra* note 94, at 681 ("[M]andated disclosure serves the autonomy principle. It implements the belief that people make better decisions for themselves than anyone can make for them and that people are presumptively entitled to freedom in making decisions.").
119. By requiring the party with superior information to share it with her contracting partner, disclosure statutes deploy the modern contract law norms of fairness (by attempting to level at least the information playing field) and cooperation (by literally mandating the disclosure of relevant information).

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Second, disclosure statutes are designed to affect the core of contract law (formation)<sup>120</sup> while simultaneously leaving it intact. That is, the primary purpose of disclosure statutes is to alleviate bargaining inequalities, at least in the form of some information asymmetry,<sup>121</sup> thereby increasing the quality of the “weaker contracting party’s”<sup>122</sup> mutual assent. Disclosing relevant information during the contract formation stage, in other words, is supposed to produce an informed choice. It is then much easier to justify holding a party to her contract via the presumption of contract validity<sup>123</sup> if that party appears to have made an informed decision to enter into the contract to begin with. Disclosure statutes, therefore, affect the core of contract by specifically targeting and manipulating mutual assent. But ultimately, and consistent with the modern contract law system’s approach to formation,<sup>124</sup> disclosure statutes leave the core completely intact, because mutual assent is established and a contract is still formed.

Disclosure statutes, therefore, fit squarely within the modern contract law framework. This is because all of the framework’s underlying assumptions<sup>125</sup> are at work in a disclosure-statute scenario. Specifically, if a contracting party receives certain disclosures in a specific manner, then that party will, in the first instance, read and understand them.<sup>126</sup> Thus, for example, under TILA, creditors are required to disclose in writing to the borrower, among many other things,<sup>127</sup> the finance charge<sup>128</sup> and the annual percentage rate.<sup>129</sup>

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120. *See supra* text accompanying notes 64–71 (discussing formation as core of contract law).
  121. *See supra* text accompanying notes 111–16 (discussing the primary purpose of disclosure statutes).
  122. By “weaker contracting party,” I am simply referring to the contracting party that is not in possession of the information deemed relevant by the disclosure statute or rule.
  123. *See supra* text accompanying notes 69–82 (discussing the presumption of contract validity).
  124. *See supra* text accompanying notes 64–71 (discussing modern contract’s approach to formation).
  125. *See supra* notes 56–65.
  126. Cf. Willis, *supra* note 26, at 748 (“[The thicker conception of the rational actor] assumes that [people] will, once given the information in the disclosures, use it to choose whether and which loan to take based on a rational calculus of their financial self-interest.”).
  127. For example, the creditor is required to disclose the “total sale price,” the “total of payments,” and any dollar charge or percentage amount that may be imposed solely because of a late payment. *See* 15 U.S.C. § 1638(a)(7) (2000) (total sale price); *id.* § 1638(a)(5) (total of payments); *id.* § 1638(a)(10) (late payment charges).
  128. 15 U.S.C. § 1638(a)(3) (2000).

Once provided with these disclosures, the theory is that the borrower in the TILA example will then be able to make an informed contractual decision about what the loan will cost and whether she can afford it.<sup>130</sup>

The decision that modern contract law is ultimately concerned with, however, is the borrower's decision about whether to enter into the contract or not. If the hypothetical borrower chooses to enter into the contract with the lender under these circumstances, then society can feel comfortable and even justified holding *that borrower to that contract*.<sup>131</sup>

Disclosure statutes therefore seem to presuppose that the contracts formed after mandated disclosures are private transactions between private parties who are most likely strangers to one another and therefore bargaining at arm's length (i.e., CitiMortgage and Mary Smith, in the hypothetical); individuals act as rational market actors in reaching their contractual decisions, meaning that the individual who receives the information via the disclosure statute will be able to correctly process that information and then rank her preferences according to her expected utility; and any imperfections in the market in the form of information asymmetries will not have an adverse impact on the parties' contractual decisions because disclosure statutes were specifically created to remedy them.

If these premises are correct, the argument continues, then parties should be free to bargain over just about anything they want (which is, of course, the very classical freedom of contract ideal);<sup>132</sup> and the law should give their bargain literal effect, that is, protect the parties' "justified" contractual expectations, because that contract is the

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129. 15 U.S.C. § 1664(d) (2000); 12 C.F.R. § 226.24 (2005); *see also* Willis, *supra* note 26, at 744 ("The APR is intended to express the total annual cost of borrowing, including interest and other scheduled charges and fees imposed by the lender . . . so that borrowers can comparison price shop . . .").

130. KAPLOW & SHAVELL, *supra* note 113, at 38 ("By providing consumers with information, government enables them to base their purchase decisions on correct information and thereby to avoid mistakes."); Willis, *supra* note 26, at 712.

131. Cf. Morant, *Race*, *supra*, note 44 at 909–10 ("Emphasis is placed upon the enforcement of agreements if objective assent is manifested."); Omri Ben-Shahar, *The Myth of the "Opportunity to Read" in Contract Law*, 5 EUR. REV. CONT. L. 1, (John M. Olin Law & Econ., Working Paper No. 415, 2008) [hereinafter, Ben-Shahar, *Myth*] ("[The] idea of implied-assent-to-available-but-unread-terms is appealing to scholars because of the premise . . . that it accords greater respect to individuals—that it bolsters the 'autonomy' of people.").

132. Freedom of contract is also the embodiment of the classical individual autonomy norm writ large.

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product of their voluntary and informed choice.<sup>133</sup> This latter statement is, of course, freedom of contract's well-known corollary that contracts should be kept.<sup>134</sup> The state's role in all of this is very neutral and minimal, having specified only that disclosures are required in certain limited commercial contracting situations, and the content of the disclosures to be made.<sup>135</sup>

## II. CONTRACTS AND STATE POWER

The problem with making contracts binding is that all of the assumptions modern contract law relies on<sup>136</sup> to justify this cardinal principle are deeply problematic in theory and in practice.<sup>137</sup> Because

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133. ATIYAH, *supra* note 51, at 403 ("[The fifth principle of classical contract law was that] the content of the contract, the terms and the price and the subject-matter, are entirely for the parties to settle."); Morant, *Race*, *supra* note 44, at 901 ("Self-governance and private autonomy undergird the classical theory, elaborated by the belief that private parties were in the best positions to fashion bargains appropriate for their needs. As a consequence, there is no need for paternalistic [state] intervention since autonomous individuals, exercising their free will and driven by their own preferences, will ostensibly formulate an agreement which is fitting and deserved.").
134. Given the way the modern contract law system is set up, this corollary actually means that contracts that are freely entered into will usually be enforced. This is because the corollary in practice takes the form of an almost insurmountable presumption of contract validity. See *supra* Part I.A (discussing the ways in which modern contract law makes contracts binding); Friedrich Kessler, *Contracts of Adhesion-Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 629–31 (1943); Mark Pettit, Jr., *Freedom, Freedom of Contract, and The "Rise and Fall"*, 79 B.U. L. REV. 263, 287 (1999) ("The traditional view is that freedom increases or decreases as freedom of contract increases or decreases. Freedom is maximized by allowing individuals to enter into contracts without fear of governmental sanctions for doing so, and by government enforcing those contracts—against the will of one of the contracting parties, if necessary." (footnote omitted)); Todd D. Rakoff, *Is "Freedom From Contract" Necessarily A Libertarian Freedom?*, 2004 WIS. L. REV. 477, 479–80 (analyzing Sir George Jessel's famous statement about freedom of contract and arguing that freedom of contract includes "three legal points: agreements (1) 'when entered into freely and voluntarily,' (2) 'shall be held sacred,' and (3) 'shall be enforced'")); Singer, *Realism*, *supra* note 35, at 479 ("[The classical theorists'] basic model assumed that the parties were free to agree on whatever terms they wanted. Freedom of contract meant that the parties were free to make or not make contracts, and that when they made contracts the courts would enforce the terms to which the parties had agreed.").
135. See *supra* text accompanying notes 127–33.
136. See *supra* Part I.A.
137. Ben-Shahar, *Myth*, *supra* note 131, at 2 ("Contract law owes its foundations to the days of the arm's length bargain . . . —to the notion that contract provisions come prior to the transaction and are known and custom designed by the parties. . . . It is a

the assumptions are dubious at best, modern contract law cannot justify holding parties to their contracts. Nevertheless, contract law continues to do just that. Consequently, continuing to bind parties to their contracts, absent the justification that the assumptions provide, is an *unmitigated* exercise of state power.<sup>138</sup> Such use of state power smacks of absolutism, which stands in stark contrast to the characterization of contract law as promoting voluntary transactions between private parties.

#### A. *The Assumptions in Theory and Practice*

There are six<sup>139</sup> well-established assumptions that modern contract law uses to justify making contracts binding and explain modern contract's use of disclosure statutes as a remedial tool.<sup>140</sup> In this part, the *contra-assumption* for each of the six postulates is argued to document the claim that all six of them are flawed in theory and in practice.

##### 1. The Market Is Not Self-Regulating or Largely Outside State Control

The Legal Realists showed us more than three-quarters of a century ago that the market is not self-regulating or largely outside of state control. They argued that the creation of the state was specifically intended to alter the distribution of power and wealth in

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heroic scholarly ideal, however, to preserve this module in the era of mass standard form contracts.”).

138. A few words on the distinction being drawn in the text between state power and *unmitigated* state power should suffice. It is abundantly clear that contracts are only binding because the state says they are. *See infra* Part II.A.3. By definition, “[a] contract is a promise . . . for the breach of which the law gives a remedy.” RESTATEMENT (SECOND) OF CONTRACTS § 1 (1981). Since a contract is only a contract if the law says it is, it seems redundant to belabor what in essence is already a truism. The point the article is making, however, is that the contract law system relies on assumptions about the contracting parties to *justify* the use of state power to make contracts binding. *See supra* text accompanying notes 55–65 (discussing the assumptions). Absent the justification provided by the assumptions, therefore, making contracts binding becomes an *unmitigated* use of state power.
139. Some of the assumptions are so related to one another that the only logical way to discuss them is together. For example, the modern contract law assumption about the role of the state subsumes the claims that (1) the state’s role is neutral and minimal, and (2) contracts are between two private parties. *See infra* Part II.A.4.
140. *See supra* text accompanying notes 55–65 (the assumptions), 120–130 (relationship to disclosure statutes).

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society.<sup>141</sup> This goal was accomplished through legal rules. Indeed, it was widely understood that legal rules were necessary because real freedom depended “upon opportunities supplied by institutions that involve legal regulation.”<sup>142</sup> It was also understood that “mere freedom as absence of restraint, without positive power to achieve what we deem good, is empty and of no real value.”<sup>143</sup> The state therefore created legal rules, both formal (i.e., through legislation, agency rules, and court decisions)<sup>144</sup> and “informal,” via private agreement.<sup>145</sup>

The legal rules created by private agreement were predicated on property rights,<sup>146</sup> which eventually included the right to contract.<sup>147</sup> The property rights a person owned determined that person’s bargaining power in the market<sup>148</sup> and, ultimately, what that person

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141. Cohen, *Contract*, *supra* note 32, at 562; Singer, *Realism*, *supra* note 35, at 482. See generally Morris R. Cohen, *Property and Sovereignty*, 13 CORNELL L. Q. 8, 10–11 (1928) [hereinafter Cohen, *Property*]; Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 COLUM. L. REV. 603, 603 (1943) [hereinafter Hale, *Duress*]; Robert L. Hale, *Law Making by Unofficial Minorities*, 20 COLUM. L. REV. 451 (1920) [hereinafter Hale, *Minorities*]. This insight is also well-established in historical discourse. See, e.g., WILLIAM E. FORBATH, LAW AND THE SHAPING OF THE AMERICAN LABOR MOVEMENT (1991); HENDRICK HARTOG, PUBLIC PROPERTY AND PRIVATE POWER: THE CORPORATION OF THE CITY OF NEW YORK IN AMERICAN LAW, 1730–1870 (1983); RICHARD R. JOHN, SPREADING THE NEWS: THE AMERICAN POSTAL SYSTEM FROM FRANKLIN TO MORE (1995); WILLIAM J. NOVAK, THE PEOPLE’S WELFARE: LAW AND REGULATION IN NINETEENTH-CENTURY AMERICA (1996); CHRISTOPHER L. TOMLINS, LAW, LABOR, AND IDEOLOGY IN THE EARLY AMERICAN REPUBLIC (1993).
  142. Cohen, *Contract*, *supra* note 32, at 591; see also Joseph W. Singer, *Things That We Would Like to Take for Granted: Minimum Standards for the Legal Framework of a Free and Democratic Society*, 2 HARV. L. & POL’Y REV. 139, 141 (2008) [hereinafter Singer, *Standards*] (“[The Legal Realists taught us that o]ur regulations, both statutory and common law, shape the house that we live in, and the liberty that we value comes from having built that house and the environment around it.”).
  143. Cohen, *Contract*, *supra* note 32, at 560; see also *id.* at 561–62 (“[T]he theory of . . . non-interference of the government in business[] is not really held consistently by those who so frequently invoke it.”).
  144. *Id.* at 586.
  145. Cohen, *Property*, *supra* note 141, at 11–14; Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 POL. SCI. Q. 470, 471–74 (1923) [hereinafter Hale, *Coercion*]; Mensch, *History*, *supra* note 35, at 34–35; Singer, *Realism*, *supra* note 35, at 487–88.
  146. Cohen, *Property*, *supra* note 141, at 11–14; Hale, *Coercion*, *supra* note 145, at 471–74; Mensch, *History*, *supra* note 35, at 34–35; Singer, *Realism*, *supra* note 35, at 487–88.
  147. Cohen, *Contract*, *supra* note 32, at 570.
  148. Needless to say, the more one party owns, the more bargaining power that party has and the more that party can dictate contract terms. See generally Hale, *Duress*, *supra*

would be allowed to acquire.<sup>149</sup> Ownership, therefore, also bestowed the power on individuals to dictate legal rules via their agreements because the state enforced the rights contained in a contract.<sup>150</sup> Indeed, the legal rules embodied in agreements and promises<sup>151</sup> were enforced specifically “to enable people to rely on them . . . and thus make the path of enterprise more secure.”<sup>152</sup> In fact, an increase in commercial activity inevitably led to more regulation.<sup>153</sup>

Formal and informal legal rules, therefore, existed and continue to exist by virtue of the existence of the state itself. Legal rules simply do not exist separate and apart from the fabric of society or the market. Legal rules create both.

Thus, the Realists argued persuasively that the market is itself a regulatory structure created by the state.<sup>154</sup> Our existing and developing formal and informal legal rules create a comprehensive network of regulations.<sup>155</sup> This network of regulations provides both the foundation and framework upon which the supposedly self-

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note 141, at 627–28 (“[T]he law endows some with rights that are more advantageous than those with which it endows others. It is with these unequal rights that men bargain and exert pressure on one another. These rights give birth to the unequal fruits of bargaining.”).

149. According to Morris Cohen:

Property law . . . determines what men shall acquire. Thus, protecting the property rights of a landlord means giving him the right to collect rent, protecting the property of a railroad or a public service corporation means giving it the right to make certain charges. Hence the ownership of land and machinery, with the rights of drawing rent, interest, etc. determines the future distribution of the goods that will come into being—determines what share of such goods various individuals shall acquire.

Cohen, *Property*, *supra* note 141, at 13.

150. Cohen, *Contract*, *supra* note 32, at 585–87.

151. Morris Cohen explains:

[W]hen a trade union makes an agreement with an association of employers, or even with a single employer, the result is law not only for those “represented” at the signing of the papers but for all those who wish to enter the industry at any time that the agreement is in force. This is in general true of all more or less permanently organized partnerships, companies, corporations, or other groups; and enforceable agreements between individuals, no matter on how limited a scale, are similarly part of the law by virtue of the general rules of state action that apply to them.

*Id.* at 587.

152. *Id.* at 555–57, 587, 591.

153. *Id.* at 558.

154. Singer, *Standards*, *supra* note 142, at 141.

155. *LEGAL REALISM*, *supra* note 35, at 99–100; Singer, *Standards*, *supra* note 142, at 150.

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regulating, free market is built, operated, and continues to operate.<sup>156</sup> Indeed, absent the legal structure provided by state-imposed regulation (e.g., courts, legislatures, agencies), the self-regulating free market would be unrecognizable as a market at all.<sup>157</sup>

Markets, however, are not just shaped by regulation. Deregulation also has to be taken into account because when the state fails to intervene in or deregulates a particular market, the state effectively alters the power relations that take place within it.<sup>158</sup> By refraining from acting in a formal manner,<sup>159</sup> the state essentially leaves informal rules and rule-making in place.<sup>160</sup> In effect, the state delegates to the party with more property rights and, hence, more bargaining power, the freedom to exercise superior bargaining power over the weaker party in a given market.<sup>161</sup> Thus, the state determines the distribution of power and wealth in society via its chosen mechanism of the market “both when it act[s] to limit freedom and when it fail[s] to limit the freedom of some to dominate others.”<sup>162</sup> The market, therefore, is not self-regulating or largely outside of state control.

Of course, this discussion begs an important question. What is a “market?” At its most basic, a market is simply “[a] place of commercial activity in which articles are bought and sold.”<sup>163</sup> In marketing, however, a “market” requires three things.<sup>164</sup> There must be consumers or organizations interested in a particular product. Those consumers or organizations must have the resources to purchase the product. Finally, the law, including applicable regulations, must permit the consumers or organizations to acquire the product.<sup>165</sup>

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156. Singer, *Standards*, *supra* note 142, at 150.

157. *Id.* at 141.

158. See *supra* text accompanying notes 141–56.

159. See *supra* text accompanying notes 141–56.

160. Singer, *Realism*, *supra* note 35, at 482. Sometimes the state accomplishes this by designating something a “non-market.” For example, there is technically no “market” for human organs, because it is illegal in the United States to sell one’s organs. See National Organ Transplantation Act of 1984, 42 U.S.C. §§ 273–274 (2006); NAT’L CONFERENCE OF COMM’RS OF UNIF. STATE LAWS, Uniform Anatomical Gift Act of 1987 § 10(a).

161. Singer, *Realism*, *supra* note 35, at 482; see also Cohen, *Property*, *supra* note 141, at 10–13.

162. BLACK’S LAW DICTIONARY (9th ed. 2009).

163. *Market Definition*, NETMBA, <http://www.netmba.com/marketing/market/definition/> (last visited Nov. 26, 2011).

164. *Id.*

So in the hypothetical loan transaction between CitiMortgage and Ms. Smith, the relevant market depends on the product being bought and sold. One could argue that the home mortgage loan itself is the product, in which case the relevant market would be the financial market. But because Ms. Smith obtained the home mortgage loan only to enable her to purchase a single-family house, it seems more plausible that the product at issue in the hypothetical is the house itself, which makes for a much more complicated market.

A veritable web of laws is implicated in constructing the residential housing market. For example, the construction of the real estate market in a particular locality, in this instance a racially segregated neighborhood (a.k.a. a “predominantly minority neighborhood”), is the result of specific government policies and actions,<sup>165</sup> including, but not limited to, New Deal housing programs, like the Home Owners Loan Corporation,<sup>166</sup> and agencies, particularly the Federal Housing Administration and Veterans Administration;<sup>167</sup> federal and state highway programs;<sup>168</sup> state urban

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165. For a much more complete discussion of the role of government in establishing and perpetuating racially segregated neighborhoods, see generally James A. Kushner, *Apartheid in America: An Historical and Legal Analysis of Contemporary Racial Residential Segregation in the United States*, 22 HOW. L.J. 547 (1979) and DOUGLAS S. MASSEY & NANCY A. DENTON, AMERICAN APARTHEID: SEGREGATION AND THE MAKING OF THE UNDERCLASS (1993). Other sources include James A. Kushner, *The Fair Housing Amendments Act of 1988: The Second Generation of Fair Housing*, 42 VAND. L. REV. 1049, 1061–67 (1989) [hereinafter, Kushner, *Second*] and Reggie Oh, Comment, *Apartheid in America: Residential Segregation and the Colorline in the Twenty-First Century*, 15 B.C. THIRD WORLD L.J. 385, 388–98 (1995).
166. The Home Owners Loan Corporation (HOLC) was a federal entity created in 1933 by the Roosevelt Administration. Oh, *supra* note 165, at 390. Its primary purpose was to increase home ownership among American families. *Id.* HOLC initiated and institutionalized discriminatory lending practices such that most black residents and neighborhoods received little to no federally subsidized mortgage loans. *Id.* at 391. As a result, the practices of HOLC ended up increasing home ownership only for white families in white neighborhoods. *Id.* at 390–91.
167. According to Professor Kushner:  
The most dramatic cause of segregation, however, was the mortgage insurance and loan programs administered by the Veterans Administration and the Federal Housing Administration, programs which provided the financing for America’s suburbs. Regulations required the financed properties to be segregated by conditioning subdivision approval on the inclusion of racial covenants or equitable servitudes.  
Kushner, *Second*, *supra* note 165, at 1063 (footnote omitted); see also Oh, *supra* note 165, at 391–92.
168. Kushner, *Second*, *supra* note 165, at 1064 (“The federal highway program also helped fund the segregated suburban exodus. In addition, state and local highway and urban

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renewal programs;<sup>169</sup> and, perhaps surprisingly, United States Supreme Court cases like *Brown v. Board of Education*,<sup>170</sup> *Milliken v. Bradley*,<sup>171</sup> and *San Antonio Independent School District v. Rodriguez*.<sup>172</sup> Professor James Kushner argues that, “[a]n audit of current governmental spending, taxation, and other policies would disclose a pattern of programs and policies that carry a segregating impact and would implicate the federal government as the primary contributor to and implementor of segregation.”<sup>173</sup>

And, of course, the loan that made the sale of the house in the hypothetical possible is a product of the financial market. The financial market, therefore, must also be considered a part of the larger residential housing market.

It is beyond the scope of this article to list all of the laws implicated in fabricating the residential housing market, but it is possible to provide some indication of how extensive and pervasive the law is in creating it, by focusing on the financial market. I make no claim that the examples laid out below are exhaustive. Nor am I attempting to engage in the substantive debate about whether the regulation, or lack thereof, of the financial market was sufficient to stave off or minimize the financial crisis that accompanied the crash of the housing market in the United States. The examples provided, however, are illustrative of the larger point that markets are not self-regulating or largely outside of state control. Indeed, the law created the market that enabled the subprime loan between CitiMortgage and Ms. Smith in the hypothetical to be made.

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renewal programs produced massive relocation which resettled white displacees in suburbia and blacks in the increasingly concentrated minority sections of central cities.”).

169. *Id.*
170. *Brown v. Bd. of Educ.*, 347 U.S. 483 (1954). According to Professor Kushner, “though invalidating intentionally segregated public schools, [Brown] encouraged white flight to the suburbs and their new, all-white school districts, while urban districts were taken to court to accomplish the promise of *Brown*.” Kushner, *Second, supra* note 165, at 1065.
171. *Milliken v. Bradley*, 418 U.S. 717 (1974). By “limit[ing] urban school remedies to the urban district absent a finding of a violation by the suburban districts, [Milliken] insulated the white suburbs from busing and further encouraged the establishment of separate societies.” Kushner, *Second, supra* note 165, at 1065.
172. *San Antonio Indep. Sch. Dist. v. Rodriguez*, 411 U.S. 1 (1973); Kushner, *Second, supra* note 165, at 1065 n.61 (“In refusing to equalize district school funding in [Rodriguez], . . . the Burger Court approved of racially ‘separate and unequal’ schools, and thus neighborhoods, in a cruel and ironic play on the discredited *Plessy* doctrine.”) (citation omitted).
173. Kushner, *Second, supra* note 165, at 1064.

A very brief timeline of the regulatory history of the financial market would include, among other things, the following pieces of legislation:

**1863: The National Bank Act**<sup>174</sup> (established the Office of Comptroller of the Currency (OCC));<sup>175</sup>

**1913: The Federal Reserve Act**<sup>176</sup> (established the Federal Reserve System (FRS));

**1933: The Banking Act, a.k.a., the Glass-Steagall Act**<sup>177</sup> (established the Federal Deposit Insurance Corporation (FDIC), supervised state banks not otherwise under federal regulation, extended federal supervision to all commercial banks, and separated commercial from investment banking);<sup>178</sup>

**1933: The Securities Act**<sup>179</sup> (established a federal disclosure regime for companies seeking to issue stocks for sale to the general public);<sup>180</sup>

**1934: The Securities Exchange Act**<sup>181</sup> (established the Securities and Exchange Commission (SEC) and implemented requirements for companies to file registration statements in conjunction with initial public offerings and annual disclosures);<sup>182</sup>

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174. National Bank Act, ch. 106, § 5, 13 Stat. 99–100 (1864) (codified as amended at 12 U.S.C. §§ 21–21a (2006)).
  175. U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-09-216, FINANCIAL REGULATION: A FRAMEWORK FOR CRAFTING AND ASSESSING PROPOSALS TO MODERNIZE THE OUTDATED U.S. FINANCIAL REGULATORY SYSTEM 6 fig.1 (2009); National Bank Act, ch. 106, § 5, 13 Stat. 99–100 (1864) (codified as amended at 12 U.S.C. § 1 (2006)).
  176. Federal Reserve Act, ch. 6, § 1, 38 Stat. 251 (1913) (codified as amended in scattered sections of 12 U.S.C.).
  177. The Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended at 12 U.S.C. §§ 1811–1832 (2006)).
  178. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Damon Silvers & Heather Slavkin, *The Legacy of Deregulation and the Financial Crisis—Linkages Between Deregulation in Labor Markets, Housing Finance Markets, and the Broader Financial Markets*, 4 J. BUS. & TECH. L. 301, 317 n.77 (2009).
  179. Securities Act of 1933, ch. 38, § 1 48 Stat. 74 (codified as amended at 15 U.S.C. §§ 77a–77aa (2006)).
  180. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Silvers & Slavkin, *supra* note 178, at 317 n.77.
  181. Securities Exchange Act of 1934, 15 U.S.C. §§ 78a–78nn (2006).
  182. U.S. GOV’T ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Silvers & Slavkin, *supra* note 178, at 317 n.77.

**1934: The National Housing Act**<sup>183</sup> (established the Federal Savings and Loan Insurance Corporation (FSLIC) to insure deposits of savings and loans; also established the Federal Housing Administration (FHA), which provided mortgage insurance to protect private lenders from losses associated with foreclosures on insured mortgages);<sup>184</sup>

**1989: The Financial Institutions Reform, Recovery, and Enforcement Act**<sup>185</sup> (reformed, recapitalized, and consolidated the Federal deposit insurance system; enhanced the regulatory and enforcement powers of regulatory agencies responsible for Federal financial institutions; established the Office of Thrift Supervision (OTS); FDIC absorbed FSLIC; Federal Housing Finance Board (FHFB) replaced FHLBB);<sup>186</sup>

**2000: The Commodity Futures Modernization Act**<sup>187</sup> (established principles-based structure for regulating futures exchanges and derivatives clearing organizations; clarified that some off-exchange trading would be permitted and remain largely unregulated);<sup>188</sup> and

**2002: The Sarbanes-Oxley Act**<sup>189</sup> (improved accuracy and reliability of corporate disclosures made pursuant to securities laws; established the Public Company Accounting Oversight Board (PCAOB)).<sup>190</sup>

The regulatory history, of course, does not take into account either the history of deregulation of the financial market or the extent of

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- 183. National Housing Act, ch. 847, 48 Stat. 1246 (1934) (codified as amended in scattered sections of 12 U.S.C.).
  - 184. U.S. Gov't ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Silvers & Slavkin, *supra* note 178, at 316 n.76; *id.* at 319.
  - 185. Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, 103 Stat. 183 (codified as amended in scattered sections of 12, 18, & 31 U.S.C.).
  - 186. U.S. Gov't ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, pmbl., 103 Stat. 183; *id.* § 101, 103 Stat. at 187; *id.* § 401(a)(1), 103 Stat. at 354, § 401(e)(1), 103 Stat. at 356; *id.* § 702(a)(2A)(a)(1), 103 Stat. at 413.
  - 187. Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 A-365 app. E (codified as amended in scattered sections of 7, 11, 12 & 15 U.S.C.).
  - 188. U.S. Gov't ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Commodity Futures Modernization Act of 2000, sec. 108, § 3 (codified at 7 U.S.C. § 5 (2006)).
  - 189. Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (codified as amended in scattered sections of 15 & 18 U.S.C.).
  - 190. U.S. Gov't ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Sarbanes-Oxley Act, pmbl.; *id.* § 101 (codified at 15 U.S.C. 7211 (2006)).

federal and state agency involvement in that market. A similarly brief history of deregulation would read like this: In 1980, the Depository Institutions Deregulation and Monetary Control Act<sup>191</sup> was enacted, which preempted state imposed interest rate caps.<sup>192</sup> Then, in 1982, Congress passed the Garn-St. Germain Act,<sup>193</sup> which allowed thrifts to expand beyond mortgage lending into commercial lending, credit cards, and real estate investing,<sup>194</sup> and the Alternative Mortgage Transactions Parity Act,<sup>195</sup> which relaxed restrictions on lenders' ability to offer adjustable rate mortgages.<sup>196</sup> In 1996, the National Securities Markets Improvement Act<sup>197</sup> preempted most state oversight of nationally traded securities.<sup>198</sup> Finally, in 1999, Congress passed the Gramm-Leach-Bliley Act,<sup>199</sup> which repealed the Glass-Steagall Act and eliminated restrictions on banks, securities firms, and insurance companies from affiliating with each other.<sup>200</sup> Ironically, the Gramm-Leach-Bliley Act is the piece of federal legislation that enabled Citicorp to merge with Travelers Group in 1998 to form Citigroup.<sup>201</sup> In other words, Citigroup, the parent company of CitiMortgage, exists only because the laws of the United States allowed it to spring into existence in 1998. Citigroup itself is therefore a state-created legal construct, just like the markets in which it actively participates.

As for the extent of federal and state agency involvement in the regulation of the financial market, suffice it to say that *every* financial institution has a primary federal regulator and a secondary state regulator. For example, national banks are primarily regulated on the

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191. The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in scattered sections of 12 U.S.C.).
  192. Silvers & Slavkin, *supra* note 178, at 320.
  193. Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in scattered sections of 12 U.S.C.).
  194. Silvers & Slavkin, *supra* note 178, at 320.
  195. Alternative Mortgage Transactions Parity Act of 1982, Pub. L. No. 97-320, 96 Stat. 1545 (codified as amended at 12 U.S.C. §§ 3801–05 (2006)).
  196. Silvers & Slavkin, *supra* note 178, at 321.
  197. National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, 110 Stat. 3416 (codified as amended in scattered sections of 15 U.S.C.).
  198. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; National Securities Markets Improvement Act, pmb., § 102.
  199. Gramm-Leach-Bliley Act, Pub. L. No. 106-102, 113 Stat. 1338 (1999) (codified as amended in scattered sections of 12 & 15 U.S.C.).
  200. U.S. GOV'T ACCOUNTABILITY OFFICE, *supra* note 175, at 7 fig.1; Gramm-Leach-Bliley Act, pmb.
  201. See Lissa Lamkin Broome & Jerry W. Markham, *The Gramm-Leach-Bliley Act: An Overview*, 1 (2001), available at [http://www.symtrex.com/pdfdocs/glb\\_paper.pdf](http://www.symtrex.com/pdfdocs/glb_paper.pdf).

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federal side by the Office of the Comptroller of the Currency<sup>202</sup> and, in California, by the Department of Financial Institutions.<sup>203</sup> The point of noting agency involvement is not to catalogue the specific regulations issued by the federal and state regulators listed but rather to further undermine the modern contract law assumption that the market is self-regulating and largely outside of state control.

As the brief histories of regulation, deregulation, and agency involvement in the financial market demonstrate, a market is inseparable from the laws that create it. Consequently, the modern contract law assumption that markets are self-regulating and largely outside of state control is simply untenable.

## 2. Contracts Are Not Voluntary

One of the hallmarks of contract law is the notion that contracts are voluntary.<sup>204</sup> This notion of voluntariness is what ostensibly separates contracts from other areas of “public” law, like torts.<sup>205</sup> Contracts, however, are not voluntary in any way that matters.

The Legal Realists argued persuasively that contracts were not the product of voluntary assent between two private parties, but were instead the result of coercion.<sup>206</sup> To the Realists, coercion was ubiquitous and “at the heart of every bargain.”<sup>207</sup> This was because

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- 202. The Office of the Comptroller of the Currency “charters, regulates, and supervises all national banks.” *About the OCC*, OFFICE OF THE COMPTROLLER OF THE CURRENCY, <http://www.occ.treas.gov/about/what-we-do/missionlindex-about.html> (last visited Nov. 26, 2011).
  - 203. According to its website, the California Department of Financial Institutions is the state regulator responsible for overseeing “California’s state-chartered financial institutions.” CALIFORNIA DEPARTMENT OF FINANCIAL INSTITUTIONS, <http://www.dfi.ca.gov> (last visited August 30, 2011). As such, DFI is “responsible for administering state laws regulating: banks, credit unions, industrial banks, trust companies, offices of foreign banks, money transmitters, issuers of travelers checks and payment instruments/money orders, and premium finance companies.” *Id.*
  - 204. See *supra* text accompanying notes 50, 59 (discussing the modern contract law assumption that contracts are voluntary).
  - 205. See *supra* note 51 (discussing the public part of the public–private distinction).
  - 206. See generally Hale, *Coercion*, *supra* note 145, at 470; Hale, *Duress*, *supra* note 141, at 606. There is, of course, more recent scholarship on coercion. See, e.g., PIERRE BORDIEU, THE SOCIAL STRUCTURES OF THE ECONOMY (Chris Turner trans. 2005). A more thorough and nuanced analysis of coercion in contract law is, therefore, possible but beyond the scope of this article. I plan to undertake this analysis in another paper currently entitled, *Contracts, Coercion & The American Dream*.
  - 207. Elizabeth Mensch, *Freedom of Contract as Ideology*, 33 STAN. L. REV. 753, 764 (1981) [hereinafter Mensch, *Ideology*].

*mutual coercion* exists in every contract<sup>208</sup> for the simple reason that each party is entitled by law to withhold from the other his capital, labor, money, or anything else that he owns.<sup>209</sup> Coercion, therefore, is a function of ownership, which, in turn, is a function of legal entitlements because it was and is the state that creates and protects property rights.<sup>210</sup> Not surprisingly, the more one party owns (in terms of quantity or value), the more potent that party's threat to withhold becomes.<sup>211</sup> Accordingly, coercion exists whenever a party assents to a contract to avoid the consequences with which the other threatens him.<sup>212</sup> Robert Hale explained this idea in 1943:

In the complex bargains made in the course of production, some parties who deal with the manufacturer surrender a portion of their property, others their liberty not to work for him, in order to avoid his threat to withhold his money, while he, in turn, surrenders some part of the money he now owns, . . . to avert their threats of withholding from him their raw materials or their labor. . . . In consenting to enter into any bargain, each party yields to the threats of the other.<sup>213</sup>

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208. Mutual coercion literally encompasses the idea that each party to a contract coerces the other. See, e.g., Hale, *Coercion*, *supra* note 145, at 474 (discussing how customers and workers can weaken the owner's coercive power, in the case of customers, "through their law-given power to withhold access to their cash, the laborers through their *actual* power . . . to withhold their services"); Edwin W. Patterson, *Compulsory Contracts in the Crystal Ball*, 43 COLUM. L. REV. 731, 741–42 (1943) (discussing refusal to give consideration unless the promisor makes a return promise); Hale, *Duress*, *supra* note 141, at 604, 606, 626 (discussing other examples of mutual coercion). For more recent work acknowledging that mutual coercion exists in every contract, see Barnhizer, *Inequality*, *supra* note 15, at 163–65.
209. See generally Cohen, *Property*, *supra* note 141; Hale, *Coercion*, *supra* note 145; Mensch, *Ideology* *supra* note 207, at 764; Singer, *Realism*, *supra* note 35, at 486.
210. Cohen, *Property*, *supra* note 141, at 11–14; Hale, *Coercion*, *supra* note 145, at 471–74; Mensch, *History*, *supra* note 35, at 34–35; Singer, *Realism*, *supra* note 35, at 487–88.
211. Cohen, *Property*, *supra* note 141, at 11–13; Hale, *Coercion*, *supra* note 145, at 471–73; Hale, *Duress*, *supra* note 141, at 627; Mensch, *Ideology* *supra* note 207, at 764; Singer, *Realism*, *supra* note 35, at 486. The more one party owns has other important implications beyond just making that party's threat to withhold more potent. See *supra* text accompanying notes 146–52 (discussing bargaining power and how much one is allowed to acquire).
212. See, e.g., Hale, *Duress*, *supra* note 141, at 604, 606.
213. *Id.* at 606; see also Cohen, *Property*, *supra* note 141, at 12 ("If . . . somebody . . . wants to use [property] which the law calls mine, he has to get my consent. To the

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Thus, in the context of the home mortgage loan between CitiMortgage and Mary Smith, Mary Smith surrendered a portion of her property (i.e., property rights in the house she purchased via the mortgage and in her money when she agreed to repay the principal plus interest) to avoid CitiMortgage's threat to withhold the money she needed to purchase the house. Similarly, CitiMortgage surrendered some of the money it owned to avert Mary Smith's threat of withholding from it some of her property rights.

The *sine qua non* of coercion is simply that a threat induces the parties to enter the contract.<sup>214</sup> Such threats exist in the hypothetical CitiMortgage–Mary Smith loan transaction. Thus, in this way, the home mortgage loan (i.e., *the contract*) between Mary Smith and CitiMortgage is coerced.

A distinction can be drawn between the *contract* (i.e., the home mortgage loan) and Mary Smith's *decision* to purchase a house. It would be easy enough to limit the coercion argument to just the contract, since the basic point of this section is that all *contracts* are coerced, not voluntary. The fact that Mary Smith could have rented a place to live, rather than bought one, however, might seem to undercut the coercion argument being made here. The specific objection goes like this: Mary Smith could have chosen to rent a house, rather than buy one, which therefore shows that her decision to purchase her home was not coerced. In other words, because another option existed for Ms. Smith (i.e., to rent), she could not have been coerced into the choice she made to buy her house. This objection, however, is misplaced.

To begin with, coercion does not require an absence of choice.<sup>215</sup> That is, the existence of choice does not disprove the existence of coercion, because the essence of the latter is that it requires a party to

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extent that these things are necessary to the life of my neighbor, the law thus confers on me a power, limited but real, to make him do what I want.”).

214. See, e.g., Hale, *Duress*, *supra* note 141, at 604, 606.

215. See Dawson, *supra* note 101, at 266–67 (arguing that the courts in various types of duress situations were confused and misguided in thinking that volition had to be overcome before duress could be found). Dawson wrote that “courts had been slow to realize that the instances of more extreme pressure were precisely those in which the consent [(i.e., the existence of choice),] was *more* real; the more unpleasant the alternative, the more real the consent to a course which would avoid it.” Prof. Patterson specifically asks whether “compulsion negate[s] ‘freedom of consent’ and thus negate[s] consent,” and answers the question in the negative. Patterson, *supra* note 208, at 741. He states that, “[e]ven non-permissible pressure . . . does not negate consent.” *Id.* 742. For additional material discussing this point, see Hale, *Duress*, *supra* note 141, at 606.

choose the lesser of two evils.<sup>216</sup> A person will therefore choose to enter into a particular transaction to avoid the threat of something worse.<sup>217</sup>

Perhaps more importantly, the fact that someone exercised a choice does not indicate a lack of compulsion.<sup>218</sup> This is because a person's freedom to decline to enter into a particular transaction is circumscribed by the way society, at least in the United States, has been set up.<sup>219</sup> Society is premised on property rights,<sup>220</sup> which are bestowed by the state.<sup>221</sup> Property rights are not bestowed equally.<sup>222</sup> One cannot use an owner's property without the owner's consent<sup>223</sup> because the state will enforce the owner's right to keep other people's hands off of his things.<sup>224</sup> So if a person owns enough property or the right kind of property so that she has a place to live, for example, then she does not have to worry about finding shelter.<sup>225</sup> She can provide it for herself. If, however, a person does not own the right kind of property, she has to get an owner's consent to use his property.<sup>226</sup> And an owner will not give his consent unless he is

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216. Hale, *Duress*, *supra* note 141, at 618 (discussing Justice Holmes's opinion in *Union Pac. R.R. v. Pub. Serv. Comm'n*, 248 U.S. 67, 70 (1918)).

217. *Id.* at 605–06.

218. *Id.* at 606.

219. Hale, *Coercion*, *supra* note 145, at 470; Hale, *Duress*, *supra* note 141.

220. See generally Cohen, *Property*, *supra* note 141, at 11–14.

221. *Id.*

222. See *supra* text accompanying notes 148–52, 208–13. Recall also that one's property rights determines one's bargaining power in the market and, therefore, the amount one will ultimately be allowed to acquire. See *supra* text accompanying notes 148–52.

223. Cohen, *Property*, *supra* note 141, at 12 (“If then somebody else wants to use [property] which the law calls mine, he has to get my consent. To the extent that these things are necessary to the life of my neighbor, the law thus confers on me a power, limited but real, to make him do what I want.”); Hale, *Coercion*, *supra* note 145, at 471 (“What is the government doing when it ‘protects a property right’? Passively, it is abstaining from interference with the owner when he deals with the thing owned; actively, it is forcing the non-owner to desist from handling it, unless the owner consents.”).

224. See Hale, *Duress*, *supra* note 141, at 604 (“The owner of the shoes or the food or any other product can insist on other people keeping their hands off his products. Should he so insist, the government will back him up with force.”). See generally Cohen, *Property*, *supra* note 141, at 11–14.

225. Of course, more is at stake with property ownership than merely not having to worry about housing. According to Morris Cohen, “[i]n a regime where [property] is the principal source of obtaining a livelihood, he who has the legal right over the [property] receives homage and service from those who wish to [make use of] it.” Cohen, *Property*, *supra* note 141, at 12.

226. *Id.*

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paid.<sup>227</sup> Consequently, without property of one's own and absent an owner's consent, a person will have to go without whatever it is, in this instance, a place to live. Hence, in reality, one's "choice" to pay an owner for use of his property is really an effort to avoid the threat of something worse, which is the essence of coercion—having to choose the lesser of two evils.<sup>228</sup>

In the context of the CitiMortgage—Mary Smith hypothetical, Mary Smith had to decide whether to purchase a home. Her decision really came down to a decision to go without shelter (and be homeless), submit to the threat of some other owner (either to rent or buy the other owner's property),<sup>229</sup> or submit to the threat of the owner whose house she was interested in. It seems pretty clear that the consequences of being homeless are much worse than the consequences of paying an owner to use his property, otherwise people would not pay owners for a place to live.<sup>230</sup> Thus, if Mary Smith had chosen to rent rather than be homeless, her decision to rent would have been coerced—she chose the lesser of two evils to avoid the threat of being homeless.

In deciding whether to rent or buy a home, Mary Smith was essentially confronted with a choice of threats—pay an owner what he wants for his property or go without a place to live. But either way, Smith was confronted with a threat. The only question is which option (renting or buying) presents the lesser evil? Given that home

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- 227. Hale, *Duress*, *supra* note 141, at 604 ("Any person, in order to live, must induce some of the owners of things which he needs, to permit him to use them. The owner has no legal obligation to grant the permission. But if offered enough money he will probably do so; for he, too, must obtain the permission of other owners to make use of *their* goods, and for this purpose he too needs money . . . ."); *see also* Cohen, *Property*, *supra* note 141, at 13.
  - 228. Hale, *Duress*, *supra* note 141, at 618 (discussing Justice Holmes's opinion in *Union Pac. R.R. v. Pub. Serv. Comm'n*, 248 U.S. 67, 70 (1918)).
  - 229. Threats exist in this other context for the same reason that there was mutual coercion and, therefore, mutual threats in the context of the CitiMortgage—Mary Smith home mortgage loan. If Mary Smith had to deal and ultimately contract with another owner for a place to rent or buy, that owner would essentially be threatening to withhold his property unless Mary Smith paid him what he wanted for its use. *See supra* text accompanying notes 208–26 (discussing the mutual coercion in the CitiMortgage—Mary Smith loan).
  - 230. *See Hale, Coercion*, *supra* note 145, at 472 ("[T]he consequence of abstaining from a particular bag of peanuts would be, either to go without such nutriment altogether . . . , or to conform to the terms of some other owner. Presumably at least one of these consequences would be as bad as the loss of the five cents [for the bag of peanuts], or the purchaser would not buy . . . .").

ownership is set up to be the more attractive option,<sup>231</sup> the choice representing the lesser of the two evils is the decision to buy. Mary Smith's decision to buy her home, therefore, was itself coerced.

Consequently, the fact that Ms. Smith chose to buy a home does not in any way eliminate the coercion that exists in her home mortgage contract with CitiMortgage. Instead, it demonstrates that context matters, contracts are not entered into in a vacuum, and coercion is broad and pervasive in contracts.<sup>232</sup>

But just because coercion is involved in the making of every contract is not to say that there is a problem with every contract or even that every contract is in need of a remedy.<sup>233</sup> It is to say,

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231. For example, homeownership is one of the primary ways to build personal wealth through the equity that accumulates in property over time, which, in turn, enables the homeowner to fund education and other things. *See, e.g.*, Dana L. Kaersvang, Book Note, *The Fair Housing Act and Disparate Impact in Homeowners Insurance*, 104 MICH. L. REV. 1993, 1994 (2006); Rick Santorum, *Wealth Creation in the New Millennium: Transforming Poverty in America*, 16 NOTRE DAME J.L. ETHICS & PUB. POL'Y 383, 391 (2002). Homeowners also enjoy tax incentives not available to renters. *See, e.g.*, I.R.C. § 163(3) (2006) (permitting deduction for home mortgage and home equity interest payments); I.R.C. § 164(a)(1) (permitting deduction for state and local real property taxes); Kenya Covington & Rodney Harrell, *From Renting to Homeownership: Using Tax Incentives to Encourage Homeownership Among Renters*, 44 HARV. J. ON LEGIS. 97, 106 (2007) (discussing specific tax benefits enjoyed by homeowners vis-à-vis renters); Mark Andrew Snider, *The Suburban Advantage: Are the Tax Benefits of Homeownership Defensible?*, 32 N. KY. L. REV. 157, 157–58 (2005) (noting that tax benefits are available to homeowners, not renters).
232. I am very mindful of the potential risk involved in claiming that every contract is coerced, namely, that this may lead to trivialization of the phenomenon (as simply a fact of life) instead of a more serious consideration of it. Part of the problem stems from the negative connotation associated with the term “coercion.” *See* Hale, *Coercion*, *supra* note 145, at 474–75. I also recognize that coercion occurs on a spectrum, with the CitiMortgage–Mary Smith hypothetical representing a more coercive situation than, say, a person stopping to buy a candy bar at a convenience store on a road trip. *See infra* text accompanying notes 337–54 (discussing the candy bar hypothetical). I am certainly not trying to trivialize coercion in contracting by claiming that all contracts are coerced. I am, however, making a very pointed argument that contracts are not voluntary in ways that matter. More than this, I am also suggesting a possible paradigm shift away from a view of contracts as a voluntary transaction to one premised on coercion. *See* Danielle Kie Hart, *Contracts, Coercion & The American Dream* (working paper) (on file with author).
233. Hale, *Coercion*, *supra* note 145, at 471 (“[T]o call an act coercive is not by any means to condemn it.”); *id.* at 474–78 (discussing the nature of coercion); Patterson, *supra* note 208, at 742 (“[A] line must be drawn, not between pressure and no pressure, but between permissible and non-permissible pressure.”); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 176 cmt. a (1981) (“[Implied] threats are an accepted part

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however, that contracts are not voluntary, notwithstanding modern contract law's claim to the contrary.

### 3. Contracts Are Public, Not Private

According to modern contract law, contracts are private.<sup>234</sup> But here again, modern contract law is mistaken. Contracts are public for two related reasons.

First, contract law does not enforce every promise a person makes. It only enforces some of them.<sup>235</sup> Through its courts, legislatures, and agencies, the state determines which contracts will be enforced.<sup>236</sup> This determination necessarily requires courts and legislatures to make policy choices between competing principles and values, such as freedom and security.<sup>237</sup> These policy choices are matters of public concern. Here, the state (through its contract law and regulation, or lack of regulation, of the residential housing market) has made a public policy choice that subprime loans, like the one between CitiMortgage and Mary Smith in the hypothetical, are enforceable.<sup>238</sup> Once it is acknowledged that the decision about

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of the bargaining process. A threat does not amount to duress unless it is so improper as to amount to an abuse of that process.”).

234. See *supra* text accompanying notes 51, 56.
235. Cohen, *Contract*, *supra* note 32, at 585; Singer, *Realism*, *supra* note 35, at 485. Once the state (through its judges and legislators) determines which contracts are enforceable, the state will then enforce those state created contract rights by literally putting the sovereign power of the state in the service of one contracting party against the other. It accomplishes this by compelling one of the parties (through its judges, sheriffs, and other state agents) to either pay or perform.
236. Singer, *Realism*, *supra* note 35, at 485. See generally Cohen, *Contract*, *supra* note 32, at 562, 585–92.
237. See Feinman, *Critical*, *supra* note 58, at 841–42; Mensch, *Ideology*, *supra* note 207, at 759; Singer, *Realism*, *supra* note 35, at 484–85. See generally Cohen, *Contracts*, *supra* note 32.
238. See Phillips v. Mortg. Elec. Registration Sys., No. 1:09-CV-01028-OWW-SMS, 2009 WL 3233865, at \*3 (E.D. Cal. Oct. 2, 2009) (granting lender's motion to dismiss plaintiff's complaint with prejudice); Rangel v. DHI Mortg. Co., No. CV F 09-1035 LJO GSA, 2009 WL 2190210, at \*1, \*3–4, \*12 (E.D. Cal. July 21, 2009) (granting lender's motion to dismiss plaintiff's complaint with prejudice); City of Cleveland v. Ameriquest Mortg. Sec., Inc. 621 F. Supp. 2d 513, 530–31 (N.D. Ohio 2009), *aff'd*, 615 F.3d 496, 505–07 (6th Cir. 2010) (“There [was] no question that the subprime lending that occurred in Cleveland was conduct which ‘the law sanctions,’ and as such, it [could not] be a public nuisance.”); Rogers v. Am. Brokers Conduit, No. 2:09-CV-715 TS, 2009 WL 3584323, at \*3 (D. Utah Oct. 26, 2009) (granting lender's motion to dismiss plaintiff's complaint). The plaintiffs' complaints in all three cases included, among other things, claims for suitability, negligence, breach of fiduciary duty, negligent and intentional misrepresentation, breach of implied covenant of good

contract enforceability comes down to a policy choice, nothing separates private law from public politics.<sup>239</sup>

Second, specifically because the subprime loan in the hypothetical is legally enforceable, the state (through its judges, sheriffs, and other state agents) will step in to enforce the obligations contained in that contract by compelling Mary Smith, the borrower, to either pay to get out of it, perform it, or file bankruptcy as a result of it.<sup>240</sup> Thus, because the state decides whether a given type of contract is

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faith, unfair lending practices, and wrongful foreclosure. *See generally* STAFF OF S. COMM. ON BANKING, HOUSING AND URBAN AFFAIRS, *Predatory Lending Practices: Staff Analysis of Regulators' Responses*, 54 CONSUMER FIN. L.Q. REP. 228, 230–31 (2000) (specifically noting distinction between illegitimate predatory lending practices, and legitimate and legal subprime lending).

239. All law is politics is, of course, one of the main critiques leveled by the Critical Legal Studies movement against law in general. In brief, CLS scholars argued that all law is politics, because the discourses of law and politics are essentially the same. Cf. Joseph William Singer, *The Player and the Cards: Nihilism and Legal Theory*, 94 YALE L.J. 1, 60 (1984) [hereinafter Singer, *Player*]. That is, every argument that can be made in the legislative arena can be, and usually is, also made in court. *See, e.g.*, Robert Mangaberia Unger, *The Critical Legal Studies Movement*, 96 HARV. L. REV. 561, 565 (1983). Law, therefore, is really just an elaborate political ideology. Feinman, *Critical*, *supra* note 58, at 852. A good example of the “all law is politics” point is the different treatment given surrogacy contracts in different states. *Compare*, *e.g.*, ARIZ. REV. STAT. ANN. § 25-218 (2011) (prohibiting surrogate parenting contracts), and *Itskov v. N.Y. Fertility Inst., Inc.*, 813 N.Y.S.2d 844, 845 (N.Y. App. Div. 2006) (holding surrogate parenting agreement unenforceable as against public policy), *with* FLA. STAT. ANN. § 742.15 (West 2011) (surrogate contracts enforceable), and *J.F. v. D.B.*, 879 N.E.2d 740, 741 (Ohio 2007) (holding gestational-surrogacy contract did not violate public policy of Ohio and was enforceable).
240. *See Cohen, Contract*, *supra* note 32, at 585–86; Singer, *Realism*, *supra* note 35, at 483. Ms. Smith could lack the financial resources to pay or perform her contract with CitiMortgage or to file bankruptcy to discharge her obligations under it. In that case, Ms. Smith would simply have to wait for CitiMortgage to declare a default and sue to foreclose on the mortgage. CitiMortgage would also sue for any deficiency resulting from the foreclosure sale of Ms. Smith’s house. This deficiency judgment would then enable CitiMortgage to garnish some of Ms. Smith’s wages and seize any other assets Ms. Smith might own now or in the future, until the deficiency judgment is paid in full. In essence, if Ms. Smith ends up doing nothing, because she lacks the financial resources to act, she will end up being forced to pay to get out of her contract with CitiMortgage. One could also argue that Ms. Smith would be forced to perform her contract, because her performance obligation to CitiMortgage consists of paying the amounts specified in the contract. In either event, and specifically because she entered into a binding contract with CitiMortgage, the state would end up forcing Ms. Smith to either pay to get out of her contract or perform it.

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enforceable<sup>241</sup> and will actually enforce those contracts, contracts are public, not private.

**4. The State's Role is Neither Neutral Nor Minimal and, Therefore, Contracts Are Not Just Between Two Private Parties**

As previously shown, the state constructs the market.<sup>242</sup> Notwithstanding this evidence, one of the biggest myths that the modern contract law system adheres to is that the role of the state is neutral and minimal.<sup>243</sup> The state's role is neither because, in addition to fabricating the market, the state also determines everyone's legal entitlements in the form of property rights, which then directly impact each person's ability to contract,<sup>244</sup> and ultimately decides which contracts will be enforceable.<sup>245</sup> Clearly, therefore, the state plays an active role in every contract, and, as a result, its role is neither neutral nor minimal.<sup>246</sup> Indeed, and as shown by the state's active role in the subprime loan contract between CitiMortgage and Mary Smith, it is impossible to say that contracts are just between private parties.<sup>247</sup> The state is as much a party to each contract as the contracting parties themselves.

**5. Individuals Do Not Act Rationally in the Marketplace, Nor Are Contracts the Product of Informed Choice**

To understand the critique of modern contract law's rational-actor assumption,<sup>248</sup> one must first know something about a "rational actor." A basic version of the rational actor looks like this: A person acts rationally where she perfectly processes available information about alternative courses of action and then ranks the possible outcomes in the order of expected utility.<sup>249</sup> Expected utility is

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241. See, e.g., *Shelley v. Kramer*, 334 U.S. 1, 18–19 (1948) (holding that when courts enforce racially restrictive covenants in real property contracts, they are engaged in state action, that is, using state power).

242. See *supra* Part II.A.1.

243. See *supra* text accompanying note 63.

244. See *supra* text accompanying notes 146–53, 200–05.

245. See *supra* Part II.A.3.

246. See Singer, *Realism*, *supra* note 35, at 482; Cohen, *Property*, *supra* note 141, at 12.

247. This is, of course, yet another assumption of modern contract law that cannot be sustained. See *supra* text accompanying note 56 (laying out the assumption).

248. See *supra* text accompanying note 58.

249. Game theory ultimately led to a series of "decisionmaking principles or axioms that rational actors were expected to honor." Hanson & Kysar, *supra* note 113, at 641. According to Hanson & Kysar, "[t]he ultimate conclusion to be derived from these axioms of decisionmaking is that players will act in the manner that maximizes their

usually defined in terms of the person's "self-interest."<sup>250</sup> Self-interest, in turn, is commonly assumed to be wealth-maximization.<sup>251</sup> So, modern contract law's rational actor will end up ranking all of the possible outcomes, based on all the information provided her, in the order in which they maximize her wealth. To be a rational actor therefore presupposes that one will not only have access to the information relevant to one's decision but will also be able to understand it and make effective use of it.<sup>252</sup> Unfortunately, none of this is true in general and not when it comes, more particularly, to contracts.<sup>253</sup>

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expected utility." *Id.* at 642. "Rational behavior," as a result, soon became synonymous with expected utility. *Id.*

The economists' model, in its purest form, is based on elegantly simple propositions about both cognitive capacities and motivations. The model assumes that a person can perfectly process available information about alternative courses of action, and can rank possible outcomes in order of expected utility. The model also assumes that an actor will choose the course of action that will maximize expected utility . . . .

Robert C. Ellickson, *Bringing Culture and Human Frailty to Rational Actors: A Critique of Classical Law and Economics*, 65 CHI.-KENT L. REV. 23, 23 (1989); see also Hadfield, *supra* note 56, at 1254; Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CALIF. L. REV. 1051, 1062 (2000) (noting that "expected utility theory" is the most dominant conception of rational choice theory in modern microeconomics); Tanina Rostain, *Educating Homo Economicus: Cautionary Notes on the New Behavioral Law and Economics Movement*, 34 LAW & SOC'Y REV. 973, 977 (2000); Willis, *supra* note 26, at 741.

250. Korobkin & Ulen, *supra* note 249, at 1064 (discussing a "thicker" version of the rational actor theory in which the actor's own goals and preferences are added to "expected utility theory's predictions about the manner in which actors will attempt to achieve their utility"; according to the authors, the most common assumption is "that actors will seek to maximize what is in their self-interest"); Willis, *supra* note 26, at 741 ("The thicker versions of rational choice theory would add that consumers' marketplace decisions reflect their own financial self-interest.").
251. Korobkin & Ulen, *supra* note 249, at 1066 ("The thickest conceptions of rational choice theory provide . . . more specific predictions about the ends of decision makers than does the self-interest version. The most common of these very thick conceptions is 'wealth maximization': the prediction that actors will attempt to maximize their financial well-being or monetary situation."); Rostain, *supra* note 249, at 977.
252. See Willis, *supra* note 26, at 741–42.
253. See Ben-Shahar & Schneider, *supra* note 94, at 705 ("[M]andated disclosure rests on false assumptions: that people want to make all the consequential decisions about their lives, and that they want to do so by assembling all the relevant information, reviewing all possible outcomes, reviewing all their relevant values, and deciding which choice best promotes their preferences.").

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Studies show, for example, that common form-contract language is understandable only by people with college degrees,<sup>254</sup> a group that does not comprise many contracting parties,<sup>255</sup> particularly consumers.<sup>256</sup> In addition, basic microeconomics continues to confirm that market failures in the form of information asymmetries remain fairly common,<sup>257</sup> obtaining information imposes costs,<sup>258</sup> and parties do not have equal access to information.<sup>259</sup>

Of course, even if parties did have equal access to information, behavioral law and economics tells us that individuals do not consider all of the “salient” information,<sup>260</sup> where salience can be defined as prominent information that individuals actually pay attention to in making their rational contractual decisions.<sup>261</sup> What

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- 254. *Id.* at 712 (“[D]isclosures are chronically hard to read. Financial-privacy notices are written, on average, at a third- or fourth-year college reading level.”).
  - 255. According to Ben-Shahar & Schneider, “over 40 million adults are functionally illiterate, ‘and another 50 million have marginal literacy skills.’” *Id.* at 711 (quoting Ad Hoc Comm. On Health Literacy for the Council Council on Scientific Affairs, Am. Med. Ass’n, *Health Literacy: Report of the Council on Scientific Affairs*, 281 JAMA 552, 552 (1999)). Significantly, “[r]ates of innumeracy are even worse than rates of illiteracy.” *Id.* at 712.
  - 256. See *id.* at 712 (“[O]nly 3% to 4% of the population can understand the language in which contracts are drafted.”); Garvin, *supra* note 114, at 310–11 & n.62 (discussing the different studies).
  - 257. Rubin, *supra* note 114, at 1909–10 (noting that market failure in the form of information asymmetry occurs fairly frequently).
  - 258. See, e.g., Bar-Gill & Warren, *supra* note 27, at 13; Garvin, *supra* note 114, at 308 (“As Herbert Simon has observed, both information and its assimilation are costly, so we must make decisions based on incomplete information.”); Rubin, *supra* note 114, at 1910 (“Even if the consumer is entirely rational, the opportunity cost of obtaining . . . information may exceed the advantage of doing so, which means that there is no way for the consumer to remedy the asymmetry efficiently.”).
  - 259. See, e.g., KAPLOW & SHAVELL, *supra* note 113, at 36 (“It is a commonplace that consumer information is often imperfect . . .”).
  - 260. Lauren E. Willis, *Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending* 19–20 (Loyola Law Sch., L.A., Working Paper No. 2, 2005) (“[M]ost people use only four or five salient decision attributes in making complex decisions; beyond that number, decisionmaking [sic] quality goes down. When under stress, people reduce the number of attributes under consideration even more radically, to fewer attributes.”) (footnote omitted).
  - 261. See, e.g., Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1206 (2003). Cf. Whitford, *Disclosure*, *supra* note 102, at 424 (“In a rough layman’s sense, it might be said that disclosure regulation typically pertains to a cluster of considerations that need to be weighed in determining the ‘best buy’ for one’s money.”).

information is salient, therefore, will vary depending on the contractual context.<sup>262</sup>

Behavioral law and economics also tells us that individuals do not act rationally in the marketplace for many reasons.<sup>263</sup> I will touch on two. First, people are “boundedly rational,” which simply refers to the fact that human cognitive abilities are limited.<sup>264</sup> What this means is that human beings end up taking mental short cuts to help them make reasonably good decisions that provide them with more or less acceptable results, but results that may not necessarily maximize their wealth.<sup>265</sup> Second, people’s preferences are affected by the context in which the information is presented.<sup>266</sup> Studies have shown, for example, that test subjects will change their preferences based solely on the way in which the options are presented to them.<sup>267</sup> The obvious result is that the party in position to frame the choice can alter the decision ultimately made, notwithstanding the test subject’s expected utility or desire for wealth maximization.<sup>268</sup>

But what does all of this mean in the context of the hypothetical subprime loan transaction between CitiMortgage and Mary Smith? The hypothetical made clear that TILA and RESPA were complied with, and, therefore, no statutory violation occurred.<sup>269</sup>

Practically speaking, this means that CitiMortgage gave Ms. Smith her initial RESPA disclosures (the good faith estimates) three days after receiving her loan<sup>270</sup> and her final TILA and RESPA disclosures at loan closing.<sup>271</sup> Practically speaking, this also means that Ms. Smith probably did not read the disclosures, let alone the loan documents.<sup>272</sup> Even if she did read them, she, like most consumers,

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262. See, e.g., Korobkin, *supra* note 261, at 1225–44.

263. See generally Garvin, *supra* note 114, at 302–25; Korobkin, *supra* note 261, at 1206, 1208–16.

264. See Jolls, Sunstein & Thaler, *supra* note 83, at 1477.

265. Garvin, *supra* note 114, at 308–09; Korobkin & Ulen, *supra* note 249, at 1143.

266. Rostain, *supra* note 249, at 978 (“People’s preferences . . . are shaped by the very process by which they are elicited.”). This is what the behavioral law and economics literature refers to as “framing effects.” *Id.*

267. Hanson & Kysar, *supra* note 113, at 644 (discussing the work and studies of Tversky and Kahneman); Rostain, *supra* note 249, at 978 (“[E]xperimental evidence establishes that preferences depend importantly on how choices are described.”).

268. See, e.g., Hanson & Kysar, *supra* note 113, at 685; Jolls, Sunstein & Thaler, *supra* note 83, at 1534.

269. See *supra* text accompanying notes 16–30.

270. Willis, *supra* note 26, at 745.

271. *Id.* at 747.

272. Cf. Ben-Shahar, *Myth*, *supra* note 131, at 2 (“Real people don’t read standard form contracts.”).

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probably would not have understood them<sup>273</sup> because the disclosures are extremely complicated.<sup>274</sup> And, because she didn't understand them, Ms. Smith would have been unable to shop for better terms.<sup>275</sup>

In addition, the loan documents would have been framed in a way that downplayed the risks of the loan;<sup>276</sup> the only salient piece of information Ms. Smith probably focused on was the monthly payment;<sup>277</sup> and Ms. Smith probably took mental short cuts to help her make her decision, like discounting the likelihood that adverse events, such as an upward adjustment to her adjustable rate mortgage and prepayment penalties, might occur in the future.<sup>278</sup>

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273. See generally Bar-Gill & Warren, *supra* note 27, at 29 (“A recent FTC survey found that many consumers do not understand, or even identify, key mortgage terms.”) Willis, *supra* note 26, at 751–54 (discussing consumers’ financial illiteracy); *id.* at 763–64 (arguing that financial illiteracy is a bigger problem for subprime loan borrowers).
274. Bar-Gill & Warren, *supra* note 27, at 27–32 (citing a survey by the Center for American Progress and the Center for Responsible Lending, which found that 38% of consumers found mortgage loans too complicated to understand, and this finding was confirmed by a 2006 study by the United States Government Accountability Office and other studies as well); Willis, *supra* note 26, at 752 (“The disclosures are not presented in simple enough lay terms and many borrowers ignore the disclosures as incomprehensible legally mandated gobbledegook.”). See generally Bar-Gill, *supra* note 16, at 1102–06.
275. See Willis, *supra* note 26, at 749–54; cf. Bar-Gill & Warren, *supra* note 27, at 31 (“Consumers who lack information about the basic operation of credit products, who do not understand annual percentage rates, or who do not know that they have been charged substantial fees, cannot make effective comparisons among products.”).
276. See Willis, *supra* note 26, at 785–88; cf. Bar-Gill & Warren, *supra* note 27, at 53–54 (noting that mortgage products defer a lot of the loan’s actual costs into the future and the disaggregation of fees in mortgage loans).
277. Willis, *supra* note 26, at 780, 788; cf. Bar-Gill & Warren, *supra* note 27, at 29 (citing an FTC survey that found that “many consumers do not understand, or even identify, key mortgage terms”).
278. Willis, *supra* note 26, at 776–79. Indeed, Professor Bar-Gill notes that [i]mperfectly rational borrowers will not be able to effectively aggregate multiple price and nonprice dimensions and discern from them the true total cost of the mortgage product. Inevitably, these borrowers will focus on a few salient dimensions. If borrowers cannot process complex, multidimensional contracts and thus ignore less salient price dimensions, then lenders will offer complex, multidimensional contracts, shifting much of the loan’s cost to the less salient dimensions.
- Bar-Gill, *supra* note 16, at 1079.

In short, people simply do not rank their preferences based on their expected net utility, because they can't.<sup>279</sup> In other words, people do not act rationally in the market in the ways that modern contract law presupposes that they do.<sup>280</sup> As a result, contracts are not the product of rational choice, nor are they the product of informed choice, despite modern contact law's assertions to the contrary.<sup>281</sup>

Notwithstanding that the modern contract law system's rational actor assumption is flawed in theory and practice, it presents yet another opportunity for modern contract law to show that it is a self-legitimizing system.<sup>282</sup> Forced to acknowledge that people do, in fact, enter into contracts that cannot be explained as exercises of rationality, modern contract can avoid questioning its assumption of rationality by attributing all apparent irrationality to lack of available information. More specifically, the modern contract law system assumes that people need information to act rationally in making their contract decisions.<sup>283</sup> At the same time, the system recognizes that people do not always have access to the information they need. Therefore, any apparent irrationality can be attributed to a lack of relevant information. But to the extent that people do not act rationally because of a lack of relevant information, the situation can be remedied relatively easily via disclosure statutes. Disclosure statutes do not actually solve the irrationality problem—in fact they probably exacerbate it,<sup>284</sup> but this is not really the point. The point is that because the information deemed relevant is provided to the contracting parties in need of it, modern contract law can then assume

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279. See Rostain, *supra* note 249, at 978 (“People reason poorly about risk, tend to jump too quickly to erroneous conclusions from incomplete information, and are otherwise poor statisticians. In short, they consistently fail to determine the most efficient means to achieve their preferences.”).
280. See *supra* text accompanying notes 248–59. That people do not act rationally in the market in the way modern contract law assumes they do is very different from saying that people do not act in a boundedly rational way. In fact, the whole point of the discussion in the text is to show that a boundedly rational actor, which is the type of market actor that exists in the real world, is not the same beast as modern contract law's rational actor.
281. See *supra* text accompanying notes 53–55, 58–59.
282. See *supra* text accompanying notes 88–101. I need to thank my friend and colleague Professor Katherine C. Sheehan for helping me work out this argument.
283. See Ben-Shahar & Schneider, *supra* note 94, at 650 (“[M]andated disclosure . . . rests on a plausible assumption: that when it comes to decisionmaking [sic], more information is better than less. More information helps people make better decisions, thus bolstering their autonomy.”).
284. See *infra* Part III.B.

once again that people will act rationally in the marketplace. Hence, the rational actor assumption is reaffirmed and thereby re-legitimated, which, in turn, leaves the framework for the modern contract law system intact. An intact framework means that modern contract law remains justified in binding people to their contracts. Or so the argument goes.

#### 6. Parties Do Not Bargain at Arm's Length and They Are Not, Most Likely, Strangers to One Another

One last modern contract law assumption needs to be examined, namely that parties to a contract bargain at arm's length and are most likely strangers to one another.<sup>285</sup> As with all of the other assumptions, this one is also contestable in theory and practice because all contracts are relational.<sup>286</sup>

One might argue, however, that the subprime loan transaction between CitiMortgage and Mary Smith in the hypothetical is at arm's length because the parties probably did not spend a lot of time together before or during the closing of the loan,<sup>287</sup> they are not going to have an ongoing relationship (because the loan was bundled and sold as a mortgage backed security), and it was probably a one-time deal. However, rather than being "discrete,"<sup>288</sup> the hypothetical contract is in fact relational.

To define and understand a relational contract requires an exploration of the late Professor Ian Macneil's relational contract

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285. See *supra* text accompanying notes 55, 57.

286. Contracts tend to fall along a relational-discrete continuum—some contracts have more relational elements than others at the other end of the spectrum. See Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 Nw. U. L. REV. 877, 894–96 (2000) [hereinafter Macneil, *Challenges*]; Feinman, *Relational*, *supra* note 48, at 739. See generally William C. Whitford, *Ian Macneil's Contribution to Contracts Scholarship*, 1985 WIS. L. REV. 546 (1985) [hereinafter Whitford, *Contribution*]. Notwithstanding this continuum, all contracts are relational because even the most "discrete" contract contains relational elements. See *infra* text accompanying notes 291–321.

287. See, e.g., Willis, *supra* note 26, at 790 ("Settlement officers typically schedule home loan closings every thirty minutes . . .").

288. See Feinman, *Theory*, *supra* note 36, at 1301 ("Some exchanges are relatively discrete, involving short duration, limited party interactions, and precise measurement of the value of the objects exchanged."); Whitford, *Contribution*, *supra* note 286, at 546 ("[C]ontracts occurring between parties who have little interaction other than the contract itself tend to fall on the discrete end of the relational-discrete continuum.").

theory.<sup>289</sup> To summarize the argument before explaining its application here, all contracts are relational because every contract is embedded in a particular “social matrix”<sup>290</sup> and in a particular social context. To Macneil, contracts are exchange relations,<sup>291</sup> and exchanges always take place within the complex social relations created by the society of which they are a part, that is, within its social matrix. With respect to this fundamental social matrix, he writes:

Exchange of any importance is impossible outside a society. Even the purest “discrete” exchange postulates a social matrix providing at least the following: (1) a means of communication understandable to both parties; (2) a system of order so that the parties exchange instead of killing and stealing; (3) typically, in modern times, a system of money; and (4) in the case of exchanges promised, an effective mechanism to enforce promises.<sup>292</sup>

Despite the seemingly discrete attributes of the hypothetical contract, therefore, CitiMortgage was only able to make the loan to Mary Smith because the social matrix of American society (i.e., a common means of communication, a system of money, etc.) made it possible. The hypothetical subprime loan is therefore relational in this first, basic sense.

A contract is also relational, however, because of its social context. More specifically, all contracts are relational because every contract is rooted in a particular social context. To fully understand a

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289. What follows is actually a very limited analysis of relational contract theory. Professor Macneil spent decades developing, articulating, refining, and advocating his theory. See generally Macneil, *Challenges*, *supra* note 286, at 877. For a more in-depth treatment, see IAN MACNEIL, THE NEW SOCIAL CONTRACT: AN INQUIRY INTO MODERN CONTRACTUAL RELATIONS (1980); Ian Macneil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Neoclassical and Relational Contract Law*, 72 NW. U. L. REV. 854 (1978); Ian Macneil, *Relational Contract Theory as Sociology: A Reply to Professors Lindenberg and de Vos*, 143 J. INST'L & THEORETICAL ECON. 272 (1987); Ian Macneil, *Values in Contract: Internal and External*, 78 NW. U. L. REV. 340 (1983) [hereinafter, Macneil, *Values*]. Figuring out what constitutes a relational contract, therefore, would only be a beginning. See Whitford, *Contribution*, *supra* note 286, at 545 (referring to Professor Macneil’s relational contract theory as a “general theory of the social order”).
290. Macneil, *Values*, *supra* note 289, at 344.
291. Macneil, *Challenges*, *supra* note 286, at 878 (“[C]ontract’ means relations among people who have exchanged, are exchanging, or expect to be exchanging in the future—in other words, exchange relations.”).
292. *Id.* at 884.

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given contract, therefore, it must be situated within the framework of the non-discrete relations, what Professor Macneil calls the “enveloping relations,”<sup>293</sup> that encompass it. This means, at a minimum, that the social context (i.e., its enveloping relations) must be understood.<sup>294</sup> But more than that, it means that an effective analysis of any transaction will require that all significant relational elements be recognized and considered.<sup>295</sup> Determining what the social context or enveloping relations are in a given transaction is an open question,<sup>296</sup> but one that will eventually be answered by “[c]ommon sense and normal practices of building knowledge on the basis of past experience.”<sup>297</sup> In general, however, the relevant social context may be broadly construed.

Macneil uses the example of relatively small increases and decreases in banana prices in supermarkets to illustrate this last point.<sup>298</sup> He argues first that the “sales of bananas occur in extremely complicated supermarket-customer relationships,”<sup>299</sup> and he sets out that relationship in some detail.<sup>300</sup> The enveloping relations in this initial discussion are confined to the “supermarket-customer relationship.” But it does not necessarily have to be so limited. He says:

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293. *Id.* at 881, 884.

294. *Id.* at 884.

295. *Id.*

296. Macneil acknowledges that “where to stop” in deciding which elements of the enveloping relations should be considered is a question. *Id.* at 885. His response is to say that, “[p]robably all that can be said generally about where to stop is that those enamored with relational contract theory will probably see important connections, and hence the need for their treatment, where those enamored with discrete analytical methods will not.” *Id.* at 886 (footnote omitted).

297. *Id.* at 884–85.

298. *Id.* at 885.

299. *Id.*

300. Thus, Professor Macneil says:

The sale of any one product is part of an integrated web of sophisticated supermarket management of the sale of all of its products. In supermarket-consumer relationships, among other things, goods are competing with each other for limited and varying display space, limited consumer attention, and expenditure of limited consumer resources. Elements of these relationships are of such a nature that even small changes in the price of a fairly simple product may send vibrations through other parts of the web, vibrations likely to reverberate back.

*Id.*

[B]anana relations are phenomenally complex. Their sale is entwined in a particularly tangled international marketing and power structure. It involves monopolistic outfits like Chiquita International Brand, a variety of conflicting third-world interests (Latin American countries, Chiquita and Chiquita-lookalike producers vs. small Caribbean island countries, particularly non-Chiquita-like producers), and European vs. American foreign policy, to say nothing of Chiquita as a symbol of American imperialism, environmentally damaging practices, big money politics, [and] the global capitalistic market generally . . .<sup>301</sup>

In short, the relevant social context of a given contract is potentially vast and wide-ranging and could include, for example, other significant relationships: domestic and international markets, domestic and foreign policy, as well as international and domestic law. Moreover, the complexity of the seemingly simple “banana relations” detailed in the quote are similar to the relations involving subprime loans, like the one in the CitiMortgage–Mary Smith hypothetical.

Thus, the social context for the hypothetical subprime loan could logically include, among other things, CitiMortgage’s relationship with its parent company, Citigroup; a variety of institutional entities like credit-rating agencies, insurance companies, investment-management companies (like the now-defunct Merrill Lynch and Lehman Brothers); hedge funds; the domestic and international financial and capital markets; conflicting investor interests (state pension plans, foreign states, and private investors); American and international financial policy; and big money politics.

Assuming the relevant social context for the subprime loan in the hypothetical should be more limited, it could still logically include the following: a network of laws and regulation/de-regulation of the American financial market that permitted subprime loans to be marketed and sold<sup>302</sup> and allowed the creation and sale of mortgage-backed securities;<sup>303</sup> and Ms. Smith’s subprime loan was most likely

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301. *Id.*

302. See *supra* Part II.A.1.

303. Professor Oren Bar-Gill provides a very brief and basic description of the securitization process that took place in the subprime loan market. He writes:

During the subprime expansion, origination volume shifted to mortgage companies with no independent means to fund the originated loans. These mortgage companies, and increasingly also depository institutions, sold the loans that they originated to

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bundled with other CitiMortgage originated subprime loans and either sold or mortgaged as a mortgage-backed security to various types of investors.<sup>304</sup> The context would also have to take into account that the security agreements associated with the sale or mortgage of the mortgage-backed securities would have included a provision prohibiting modification of individual loans within the bundle sold or mortgaged to prevent devaluation of the bundle as a whole, which, of course, would make individual negotiations with distressed debtors extremely difficult, if not impossible,<sup>305</sup> and that there were conflicting understandings of the lender's obligations, with the law saying that lenders (i) owe no fiduciary duty to borrowers;<sup>306</sup> (ii) have no duty to disclose whether borrowers actually

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Wall Street investment banks that pooled the loans, carved up the expected cash flows, and converted these cash flows into bonds that were secured by the mortgages. At the peak of the subprime expansion, most mortgages were financed through this process of securitization. As a result, the "owners" of the loans are the investors who purchased shares in these Mortgage (or Asset) Backed Securities (MBSs or ABSs).

Bar-Gill, *supra* note 16, at 1090–91 (footnotes omitted).

304. See *id.* at 1074–75 n.1 ("[A]nalyzing data covering approximately 85 percent of securitized subprime loans. In 2006, 75 percent of subprime loans were securitized, and the authors' data set included 1,772,000 subprime loans originated in 2006, implying a total of  $1,772,000 / (0.85 * 0.75) = 2,779,608$ ."") (citing Yuliya Demyanyk & Otto Van Hemert, *Understanding the Subprime Mortgage Crisis*, 24 REV. FIN. STUD. 1848, 1853 & n.6, 1854 tbl. 1 (2009)).
305. See Adam J. Levitin, *Purchasing Mortgage-Backed Securities Does Not Give the Government the Ability to Modify Mortgages Backing the Securities* (2008), [http://www.law.georgetown.edu/faculty/levitin/documents/MBSModificationIssues\\_00.pdf](http://www.law.georgetown.edu/faculty/levitin/documents/MBSModificationIssues_00.pdf).
306. Oaks Mgmt. Corp. v. Superior Court, 51 Cal. Rptr. 3d 561, 570 (Cal. Ct. App. 2006) ("[I]t is established that absent special circumstances . . . a loan transaction is at arms-length [sic] and there is no fiduciary relationship between the borrower and lender."); Nymark v. Heart Fed. Sav. & Loan Assn., 283 Cal. Rptr. 53, 55, n.1 (Cal. Ct. App. 1991) (rejecting breach of fiduciary duty claim by borrower and holding instead that the claim failed as a matter of law); Pimetal v. Wachovia Mortg. Corp., 411 F. Supp. 2d 32, 39 (D. Mass. 2006) (holding that lenders owe no fiduciary duty to borrowers). "The relationship between a lending institution and its borrower-client is not fiduciary in nature. A commercial lender is entitled to pursue its own economic interests in a loan transaction. This right is inconsistent with the obligations of a fiduciary which require that the fiduciary knowingly agree to subordinate its interests to act on behalf of and for the benefit of another." *Nymark*, 283 Cal. Rptr. at 55 n.1 (citations omitted); see also Lawrence v. Bank of Am. 209 Cal. Rptr. 541, 542 (Cal. Ct. App. 1985) ("[U]nder ordinary circumstances the relationship between a bank and its depositor is that of debtor-creditor, and is not a fiduciary one . . .").

qualify for the loans they are sold;<sup>307</sup> (iii) have no duty to determine the borrowers' ability to repay the loan;<sup>308</sup> (iv) have no duty to refrain from making loans to borrowers whom the lenders know cannot repay the loan;<sup>309</sup> and (v) have no duty to give borrowers the best rates<sup>310</sup>—all of which, of course, contradict the understanding held by a majority of borrowers.<sup>311</sup>

What the discussion of the social matrix and social context applicable to the home mortgage loan between CitiMortgage and Mary Smith demonstrates, therefore, is that every contract is relational. And because every contract is relational, no contract is bargained-for by strangers in an arm's-length transaction.

A “stranger” is “a person who is unacquainted with or unaccustomed to something [or] a person who is not a member of the

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- 307. *Cross v. Downey Sav. and Loan Ass'n*, No. CV\_09-317\_CAS (SSx), 2009 WL 481482, at \*9 (C.D. Cal. Feb. 23, 2009) (holding that the financial institution had no duty to disclose to the borrower that he could not qualify for the loan); *cf. Baylor v. Jordan*, 445 So. 2d 254, 256 (Ala. 1984) (“Courts have traditionally viewed the relationship between a bank and its customer as a creditor-debtor relationship which does not impose a fiduciary duty of disclosure on the bank.”); *Nymark*, 283 Cal. Rptr. at 56 (“[A]s a general rule, a financial institution owes no duty of care to a borrower when the institution's involvement in the loan transaction does not exceed the scope of its conventional role as a mere lender of money.”); *In re Vincent v. Ameriquest Mortg. Co.* (*In re. Vincent*), 381 B.R. 564, 574 (Bankr. D. Mass. 2008) (holding that plaintiff failed to allege facts that would impose a fiduciary duty on defendant (lender) “to make sure that the loan was suitable based on her circumstances”).
  - 308. *Renteria v. United States*, 452 F. Supp. 2d 910, 922 (D. Ariz. 2006) (“[T]he world might well be a better place if lenders had a duty to the borrower to determine the borrower's ability to repay the loan. No such duty exists. The lender's efforts to determine the creditworthiness and ability to repay by a borrower are for the lender's protection, not the borrower's.”); *Norwich Sav. Soc'y v. Caldrello*, No. CV89-512204, 1993 WL 268512, at \*9 (Conn. Super. Ct. July 12, 1993) (“A bank does not have a duty to investigate a borrower's ability to repay the loan.”); *Anderson v. Franklin*, No. 2:09-cv-11096, 2010 U.S. Dist. WL 742765, at \*8 (E.D. Mich. Feb. 26, 2010) (“[T]he world might well be a better place if lenders had a duty to the borrower to determine the borrower's ability to repay the loan.”).
  - 309. *Wagner v. Benson*, 161 Cal. Rptr. 516, 521 (Cal. Ct. App. 1980) (holding that the lenders did not owe a duty of care to the borrowers in approving the loan); *N. Trust Co. v. VIII S. Mich. Assocs.*, 657 N.E.2d 1095, 1102 (Ill. App. Ct. 1995) (“The lender also has no duty to refrain from making a loan if the lender knows or should know that the borrower cannot repay the loan.”).
  - 310. *See, e.g., Brazier v. Sec. Pac. Mortg., Inc.*, 245 F. Supp. 2d 1136, 1143 (W.D. Wash. 2003) (holding that no law requires a mortgage broker to negotiate for a borrower to obtain the best rate from the lender).
  - 311. *See Bar-Gill & Warren, supra* note 27, at 32 (“The 2002 Fannie Mae National Housing Survey found that over half of all African-American and Hispanic borrowers erroneously believed that lenders are required by law to provide the best possible loan rates.”).

family, group, community, or the like"; while "arm's length" means "not closely or intimately connected or associated."<sup>312</sup> Under Macneil's relational contract theory, the home mortgage contract between CitiMortgage and Mary Smith is not between strangers or at arm's length, because a social matrix and a particular social context tie these parties together. They share, for example, a common understanding of money, language, and system of order.<sup>313</sup> In addition, a myriad of customs (e.g., one should be on time for appointments and pay one's bills), understandings (spoken or unspoken and legal or not),<sup>314</sup> as well as laws and regulations<sup>315</sup> add integral parts to the relations between the parties. The transaction between CitiMortgage and Mary Smith, therefore, is "deeply embedded in a wide range of interconnected relations."<sup>316</sup> Consequently, and contrary to modern contract law's assumption,<sup>317</sup> there simply are no strangers in a given society and an arm's-length transaction is an oxymoron.

### B. The Universe of Contracts

It should be clear from the discussion in the last part of this article that all of modern contract law's assumptions are deeply flawed, if not fallacious. The implications for the efficacy of disclosure statutes should be apparent, but will be discussed in more detail later.<sup>318</sup> The broader point to be made, however, is that, because the assumptions are highly questionable, modern contract law cannot justify holding parties to their contracts. Yet the contract between CitiMortgage and Mary Smith is binding—it satisfies contract law's formation requirements, and given the presumption of contract validity, all of its terms (reasonable and unreasonable) are likely enforceable between the parties.<sup>319</sup> Consequently, absent the justification that the assumptions seemingly provide, continuing to bind Mary Smith and CitiMortgage to *this* contract is an *unmitigated* exercise of state power.<sup>320</sup>

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312. THE RANDOM HOUSE DICTIONARY OF THE ENGLISH LANGUAGE 115, 1880 (2d ed. 1987).

313. *See supra* text accompanying notes 289–92 (laying out Macneil's social matrix).

314. *See supra* text accompanying notes 289–97.

315. *See supra* Part II.A.1.

316. Macneil, *Values*, *supra* note 289, at 345.

317. *See supra* text accompanying note 57.

318. *See infra* Part III.B.

319. *See supra* text accompanying notes 64–83.

320. *See supra* note 138.

But the existence and use of this unmitigated state power within the modern contract law system is not confined to the type of contract exemplified by the CitiMortgage–Mary Smith contract. In other words, it is not confined to a bad bargain procured through the improper use of unequal bargaining power. Rather, this unadulterated use of state power extends to *all* contracts formed within the modern contract law system.<sup>321</sup>

In response to the claim that *all* contracts are made binding as an exercise of state power, one could argue that the critique of modern contract law articulated in this article covers too much. This is because some contracts “work”—both sides get what they want from the deal and walk away once the contract has been completely executed. Contracts that “work” in this manner ostensibly pose no problem, and, therefore, to the extent that the analysis includes these contracts in the critique, the critique is overbroad. It is not, for the reasons elaborated below.

Contracts can be formed in circumstances of unequal bargaining power or not, where bargaining power is defined<sup>322</sup> to include **anything**—resources (money, time, staff), experience, expertise, knowledge, etc.—that gives one party a bargaining advantage over the other party.<sup>323</sup> The terms of contracts can also be “fair” or not. Fairness in terms, however, is much harder to conceptualize, for the simple reason that “fair” does not lend itself to easy explanation or definition.

Black’s Law Dictionary, for example, defines “fair” as “[i]mpartial; just; equitable; disinterested[;] . . . [f]ree of bias or

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- 321. I need to thank my friend, Professor Nancy Kim, for bringing this issue to my attention.
  - 322. BARNHIZER, *Bargaining Power*, *supra* note 94, at 92 (“A party has bargaining power if she has the ability to effect intelligently a preferred outcome in a bargaining relationship.”).
  - 323. Some scholars appear to distinguish party sophistication from bargaining power. *See generally* Miller, *supra* note 54, at 495–96. The distinction turns on the definition of a “sophisticated party.” *See generally id.* at 494–95 (“For its ubiquity, party sophistication remains an unstudied and largely unaddressed question in contract law. Although they often mention sophistication, the extensive contract treatises of Williston, Corbin and Farnsworth do not dedicate a section to clarifying what is meant by the terminology. This article begins the discussion.”). I think it is entirely possible that the sophistication of the contracting parties is at least an element of bargaining power, if not just bargaining power under another name. In other words, the more sophisticated a party is, especially vis-à-vis its contracting partner, the more likely it is that the sophisticated party will be able to procure a contract that favors its interests. If this admittedly oversimplified analysis is correct, then it seems to me that “party sophistication” becomes just another way to say that one party has superior bargaining power.

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prejudice.<sup>324</sup> To some economists, fairness suggests that “some legal opportunities for gain are not exploited.”<sup>325</sup> To non-economists, fairness is a way to incorporate other-regarding preferences.<sup>326</sup> To political philosophers like John Rawls, fair terms are ones that a citizen might reasonably offer and which the citizens to whom such terms are offered might also reasonably accept.<sup>327</sup> Implicit in Rawls’s use of “reasonably” twice in his conception of fair terms is the understanding that the citizens he refers to are “free and equal, and not . . . dominated or manipulated, or under the pressure of an inferior political or social position.”<sup>328</sup>

Hence, fair terms seem to presuppose either the absence of superior bargaining power or the existence of superior bargaining power that is not used to exploit gain. To achieve such a result would thus seem to require implementation of a version of Rawls’s veil of ignorance.<sup>329</sup> That is, the terms of the contract would have to be determined in a situation where the parties did not know their own bargaining power and, therefore, which side of the bargaining table they would end up on (the strong or weak side).

In theory, the idea of bargaining through a veil of ignorance to achieve objectively fair contract terms is very appealing and should be explored further.<sup>330</sup> But it is unclear how workable a solution this will be because unequal bargaining power is a fact of life and expecting market actors to go against their economic self-interest to the extent necessary to produce such terms seems unrealistic. That said, some contracts are objectively better than others. A “bad bargain,” for example, is one in which the terms unreasonably favor one party.<sup>331</sup> With this understanding of a bad bargain as a baseline, a contract on fair terms would be a contract in which there is a mix of terms favorable to each party such that the terms do not unreasonably favor one of the contracting parties. The pivotal point is the point where the terms become unreasonably favorable to one of the parties, and, at that tipping point, that particular contract would be deemed

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324. BLACK’S LAW DICTIONARY (9th ed. 2009).

325. Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, *Fairness and the Assumptions of Economics*, 59 J. BUS. S285, S286 (1986).

326. Michael B. Dorff & Kimberly Kessler Ferzan, *The Perils of Forgetting Fairness*, 59 CASE W. RES. L. REV. 597, 606 (2009).

327. JOHN RAWLS, POLITICAL LIBERALISM, at xliv (1996).

328. *Id.*

329. See JOHN RAWLS, A THEORY OF JUSTICE 118–23 (rev. ed. 1999).

330. See Singer, *Standards*, *supra* note 142, at 159.

331. Hart, *supra* note 5, at 179 n.14.

unfair. In other words, a bad bargain would represent a contract on “unfair” terms.<sup>332</sup>

Notwithstanding that contracts can vary with respect to these two factors—with some having fair terms, and some resulting from no inequality of bargaining power—all of them are still subject to the critique made in this article, because all of them have something else in common. Specifically, *regardless* of whether the terms are fair or whether any inequality of bargaining power exists in formation, a contract is likely to be found to be valid and enforceable under modern contract law. This is because the presumption of contract validity springs into existence upon formation (via mutual assent and consideration),<sup>333</sup> and, for reasons discussed earlier, it is extremely difficult to overcome this presumption.<sup>334</sup> The presumption of contract validity plus enforcement means that all contracts are likely to be binding under modern contract law, including but not limited to ones that are both unfair and the product of abuse of bargaining power,<sup>335</sup> arguably like the home mortgage loan between CitiMortgage and Mary Smith.

Modern contract law does not justify contracts that have fair terms or were created with no inequality of bargaining power by pointing to their fairness or the lack of inequality. Rather, as discussed earlier, modern contract law makes contracts binding because of the assumptions the system makes about the parties, the market, and the role of the state.<sup>336</sup> All of these assumptions are ostensibly at work regardless of whether a contract was formed under circumstances of unequal bargaining power or has resulted in unfair terms. A brief hypothetical will illustrate this central point.

Assume that a man on a road trip to a place he has never been before walks into a convenience store, selects a candy bar from the shelf, and then takes it to the store clerk (whom he has never met), who rings up the sale. After paying the clerk, the man leaves the store and eats his candy bar. Despite the fact that no words were spoken, a contract for the sale of the candy bar was formed.<sup>337</sup>

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332. For purposes of this argument, it need only be assumed that a line can be drawn between fair and unfair; it is not necessary to decide where that line would be.

333. *See supra* text accompanying notes 69–83.

334. *See supra* text accompanying notes 69–83.

335. *See supra* text accompanying notes 83–85.

336. *See supra* text accompanying notes 53–63.

337. *See U.C.C. § 2-204(1) (2003)* (“A contract for the sale of goods may be made in any manner sufficient to show agreement, including . . . conduct by both parties which recognizes the existence of [such] a contract . . . .”); *accord RESTATEMENT (SECOND) OF CONTRACTS § 4 (1981)* (“A promise may be stated in words either oral or written,

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All of modern contract law's assumptions are ostensibly at work in making this simple contract binding.<sup>338</sup> Specifically, one could argue that the sale represents a private, arm's-length transaction between private parties who were literally strangers to one another. The man's choice of the candy bar was voluntary, presumably informed, and the product of rational choice. The self-regulating market worked just fine and without state interference, having only set the price of the candy bar. And the state's role with respect to the entire transaction was neutral and minimal. But just as with the subprime mortgage loan contract between CitiMortgage and Mary Smith, all of the assumptions are dubious in the context of this simple contract as well and for the same reasons.

To begin with, the market for the sale of a candy bar would be unrecognizable without the web of laws implicated in constructing the market for the sale of food, like a candy bar. This would include, but certainly not be limited to, laws governing food labeling,<sup>339</sup> manufacturing and safety regulations,<sup>340</sup> as well as extensive involvement by agencies such as the United States Department of Agriculture<sup>341</sup> and the Federal Food and Drug Administration.<sup>342</sup> Consequently, the market for the sale of a candy bar is inseparable from the laws that create the market. The candy bar market is, therefore, not self-regulating or largely outside of state control.

Nor is the contract for the candy bar voluntary, as it was procured through mutual coercion,<sup>343</sup> specifically, with the clerk implicitly saying, "pay or I withhold the candy bar," and the man implicitly responding, "give me the candy bar or I withhold my money." The

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or may be inferred wholly or partly from conduct."); *id.* § 19(1) ("The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by failure to act.").

338. *See generally supra* text accompanying notes 55–63 (listing the assumptions).
339. *See, e.g.*, Nutrition Labeling and Education Act of 1990, Pub. L. No. 101-535, 10-4 Stat. 2353.
340. *See, e.g.*, 21 U.S.C. § 348 (2006) (governing food additives); 42 U.S.C. § 242r (2006) (governing improvement and publication of data on food-related allergic responses); 21 U.S.C. § 343 (2006) (governing misbranded food); 21 U.S.C. § 374 (2006) (governing inspection of locations where food is manufactured, processed, packaged or held).
341. *See generally* U.S. DEP'T OF AGRIC., <http://www.usda.gov/wps/portal/usda/> (last visited Nov. 26, 2011).
342. *See generally*, U.S. FOOD & DRUG ADMIN., <http://www.fda.gov> (last visited Nov. 26, 2011).
343. *See supra* text accompanying notes 206–13.

contract for the candy bar was thus formed to avoid these mutual threats.

Moreover, the state says that contracts formed by conduct are valid.<sup>344</sup> The state also says that a sale of goods, like the sale of a candy bar, is enforceable<sup>345</sup> and would be enforced by the state through, for example, its shoplifting laws.<sup>346</sup> Hence, because the state decides whether the contract for the candy bar is enforceable and will actually enforce this contract,<sup>347</sup> the contract for the sale of the candy bar is public, not private.

The state was actively involved in creating the market for the sale of the candy bar and ultimately decides whether the contract for the candy bar is enforceable. For these and other reasons as well,<sup>348</sup> it would be very difficult to say that the state's role in this contract is neutral or minimal. The state, therefore, is as much a party to the contract for the sale of the candy bar as the parties to that contract themselves. Consequently, it is also impossible to say that contracts are just between private parties.

And while the man choosing a candy bar off of a convenience store shelf may not have been acting irrationally, there is also nothing to suggest that he was acting as a rational actor in making his selection. To satisfy modern contract law's version of the rational actor, the man choosing the candy bar would have to be able to rank all of the possible candy bar choices, based on all the information provided him (from the label of the available candy bars, for example), in the order in which they maximize his expected utility, which generally means maximizing his wealth.<sup>349</sup> While it is possible that some people may act in this fashion, it seems fairly safe to say that this behavior does not describe how most people purchase candy bars.<sup>350</sup> The contract for the candy bar, therefore, is not the product of informed or rational choice, at least not in the way that modern contract law constructs the rational actor.

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344. See *supra* note 337 (cites for contracts formed by conduct).

345. See generally U.C.C. §§ 2-101 to -804 (2011).

346. See, e.g., CAL. PENAL CODE § 490.1 (West 2010) (dealing with petty theft where the value taken is less than fifty dollars and stating that the punishment for petty theft is by fine not exceeding two hundred and fifty dollars).

347. See *supra* Part II.A.3.

348. See *supra* Part II.A.4.

349. See *supra* text accompanying notes 249–53 (discussing modern contract law's rational actor).

350. Cf. Ben-Shahar, *Myth*, *supra* note 131, at 2 (“Apart from an exotic individual here or there, nobody reads.”).

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Finally, the parties did not bargain at arm's length, nor were they strangers to one another, because of the social matrix<sup>351</sup> (i.e., the parties shared a common language, system of money, etc., that enabled the sale of the candy bar to take place) and the social context<sup>352</sup> within which the sale took place.<sup>353</sup> This context would include, for example, customs (one should pay for something before eating it); relational characteristics, like brand loyalty to a particular kind of candy bar; laws, including, but not limited to, local zoning laws that made having a convenience store possible in a particular location, laws pertaining to interstate travel, and Article 2 (sale of goods) of the Uniform Commercial Code; and regulations (i.e., requiring store clerks to wash their hands after using the restroom). The social matrix and social context applicable to the sale of the candy bar, therefore, show that this contract is also relational, and not an arm's-length transaction between strangers.

Thus, since all of the assumptions are deeply flawed and highly contestable, both theoretically and in practice,<sup>354</sup> the argument is that modern contract law cannot justify making any contracts binding. Nonetheless, modern contract law in practical application does just that. Consequently, the inescapable conclusion is that modern contract law makes *all* contracts binding as an unmitigated exercise of state power.

**III. CONTRACT LAW AND UNEQUAL BARGAINING POWER**

The critique so far is not that all contracts produced under the framework of modern contract law present a problem calling for a remedy or some other kind of state sponsored interference. In fact, most contracts produced by the modern contract law system would not currently require such intervention. Rather, the critique is simply that all contracts are made binding as an exercise of state power. Making contracts binding in this fashion, however, ensures that unequal bargaining power is and will continue to be a systemic and structural feature of the modern contract law system.

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351. See *supra* text accompanying notes 291–92.

352. See *supra* text accompanying notes 293–97 (explaining “social context”).

353. See *supra* text accompanying notes 291–92. The social context for the sale of the candy bar would be fairly analogous to that described in Professor Macneil’s example of the sale of bananas in a supermarket. See *supra* notes 298–301 and accompanying text.

354. See *supra* Part II.A (discussing why the six assumptions of modern contract law are flawed).

### A. Synergy: State Power and Unequal Bargaining Power

The types of power at work in the modern contract law system can be distinguished. There is state power, which makes all contracts binding,<sup>355</sup> and there is an individual contracting party's bargaining power. Continuing to distinguish them in this way is conceptually useful. But the distinction is also a fiction because individual bargaining power is power that is ultimately conferred by the state through property rights.<sup>356</sup> Recall that the state determines property rights.<sup>357</sup> Property rights, in turn, translate into individual bargaining power—the more one party owns, the more bargaining power that party commands and, therefore, the more that party will be able to dictate contract terms.<sup>358</sup> Thus, state power is always implicated and in many ways instantiated in every contract because it is present in the modern contract law system in both of these ways. A synergistic relationship is thereby created, the effect of which is to increase and reify the bargaining power of the party with more bargaining power.

The synergism works this way: Individual bargaining power enables the party with more bargaining power (the “stronger party”) to dictate contract terms. Bargaining power is increased via each contract the stronger party enters into, because the stronger party is able to reap more gains from each contract than it otherwise would with less bargaining power. The stronger party’s bargaining power is then reified each time a contract is formed, because contracts formed via mutual assent and consideration are generally going to be binding.<sup>359</sup> The premise that contracts are made binding, therefore, ensures that the stronger party will be able to retain the benefits from each of its contracts. Consequently, and over time, the stronger party will end up owning more resources (money, property, labor, capital, etc.). And then the synergism comes full circle because the more one party owns, the more bargaining power that party has, and so on.<sup>360</sup>

### B. Institutionalizing Unequal Bargaining Power

Regardless of its source, unequal bargaining power exists.<sup>361</sup> Unequal bargaining power poses difficulties for modern contract law

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355. See *supra* Part II.A.

356. See *supra* text accompanying notes 146–52, 210–12.

357. See *supra* text accompanying notes 220–21.

358. See *supra* text accompanying notes 146–49, 211.

359. See *supra* text accompanying notes 83–87.

360. See Mensch, *Ideology*, *supra* note 207, at 762.

361. See Barnhizer, *Inequality*, *supra* note 15, at 240.

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when it is used, for example, to obtain a bad bargain.<sup>362</sup> This problem is very real because modern contract law does not effectively address unequal bargaining power. First, with the exception of disclosure statutes, all of modern contract law's remedial mechanisms, like contract interpretation and defenses to enforcement, are available only after a contract is formed.<sup>363</sup> Indeed, this structural aspect of modern contract law is partly what gives rise to the presumption of contract validity.<sup>364</sup> Recall that the presumption essentially makes all contracts formed via mutual assent and consideration binding, *including* contracts procured through an improper use of unequal bargaining power.<sup>365</sup> Second, the tools modern contract law relies upon to address unequal bargaining power are ineffective.<sup>366</sup>

Because unequal bargaining power is not effectively addressed, its use and abuse within the modern contract law system remains hidden and, more importantly, unchecked. In this way, modern contract law institutionalizes unequal bargaining power, which ultimately redounds to the benefit of the party with more bargaining power. Disclosure statutes provide an excellent illustration of this argument.

In theory, disclosure statutes are supposed to provide notice to the weaker contracting party<sup>367</sup> about important terms of which she would probably not otherwise be aware. The weaker contracting party will therefore have actual knowledge, at least with respect to the disclosed terms, before expressing her assent to the contract. Since mutual assent is still a required element of contract formation,<sup>368</sup> disclosure statutes are supposed to improve the quality of the weaker party's mutual assent, by ensuring that the weaker party's assent was informed.<sup>369</sup>

Unfortunately, disclosure statutes are premised on the same assumptions that make up the framework for modern contract law.<sup>370</sup> As previously discussed in detail, all of these assumptions are

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362. See Hart, *supra* note 5, at 210–15.

363. See *supra* notes 75–77 (contract interpretation and defenses to enforcement).

364. See *supra* text accompanying notes 69–85.

365. See *supra* text accompanying notes 83, 86–87.

366. See Hart, *supra* note 5, at 198–218 (discussing in detail why modern contract law's expanded policing doctrines, namely, unconscionability, economic duress, and misrepresentation do not effectively address the unequal bargaining power, and, therefore bad bargain problems).

367. “Weaker” is used here to refer to the party that does not have access on his own to the information in the possession of the stronger party.

368. RESTATEMENT (SECOND) OF CONTRACTS §§ 17(1), 22(1) (1981).

369. See Ben-Shahar & Schneider, *supra* note 94, at 649–51.

370. See *supra* text accompanying notes 56–63.

fallacious.<sup>371</sup> As a direct result, disclosure statutes will not work.<sup>372</sup> In fact, empirical studies support this conclusion.<sup>373</sup> They will not remedy unequal bargaining power in the form of information asymmetries.<sup>374</sup> Compliance with disclosure statutes, therefore, will not *actually* increase the quality of the weaker party's mutual assent. Instead, compliance with disclosure statutes will produce two adverse outcomes, both of which serve to strengthen the presumption of contract validity.<sup>375</sup>

The obvious outcome is that compliance with disclosure statutes will give the *appearance* that the quality of the weaker party's mutual assent has increased, when in fact it has not. That is, such compliance merely improves the *image* but not the substance of the resulting contract—it is ostensibly no longer a product of power and pressure of the stronger party but an act of a better balanced and well-considered decision-making process.<sup>376</sup>

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371. See *supra* Part II.A.

372. See generally Ben-Shahar & Schneider, *supra* note 94, at 665–729 (documenting the failure of mandated disclosure and laying out in detail why mandated disclosure does not work).

373. For example, Professor Florencia Marotta-Wurgler recently conducted empirical research to examine the “informed minority” justification for disclosure statutes. Marotta-Wurgler, *Disclosure*, *supra* note 112, at 3–4. Her study made two main findings: (1) increasing contract accessibility did not result in an economically significant increase in contract readership, *id.* at 4, 18–26, 30, and (2) the very few shoppers who actually did read the online end user license agreements (EULAs) were equally likely to purchase a product regardless of whether the EULA was buyer-friendly. *Id.* at 4, 27–30. As a result, Marotta-Wurgler concluded that the informed minority justification for disclosure statutes “is simply too weak to make any difference in this setting,” and that “[d]isclosure per se [would] result in little increase in readership or economic pressure on sellers.” *Id.* at 31. Significantly, Marotta-Wurgler also notes that, since “search and access costs are so low online . . . increased contract disclosure would seem even more likely to be ineffective in increasing shopper attention [in] offline contexts as well.” *Id.*; see also Whitford, *Disclosure*, *supra* note 102, at 430–31 (focusing on Truth-in-Lending in an early attempt to assess whether disclosure statutes are effective in accomplishing their purposes, and tentatively concluding, both empirically and theoretically, that disclosure statutes would have little impact); Marotta-Wurgler, *Disclosure*, *supra* note 112, at 8–9 (citing prior empirical evidence on the effectiveness of disclosure regimes).

374. See Ben-Shahar & Schneider, *supra* note 94, at 742–43.

375. See *supra* text accompanying notes 69–83 (discussing the presumption of contract validity).

376. Cf. Ben-Shahar, *Myth*, *supra* note 131, at 3 (“[In the context of the ‘opportunity to read,’] it is now a standard view to confront the unreadness[-of-contracts] reality with myths, fictions, and presumptions, all intended to preserve a conceptual apparatus that fits a world in which transactors know all the terms”).

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The more perverse outcome,<sup>377</sup> however, is that such compliance will likely eliminate several contract policing doctrines that would otherwise be available to challenge the presumption of contract validity.<sup>378</sup> For example, a claim that the implied obligation of good faith was breached would probably fail because the term was disclosed up front.<sup>379</sup> Assuming compliance with applicable disclosure statute(s), a claim or defense based on fraud or misrepresentation, including misrepresentation in the form of a material non-disclosure,<sup>380</sup> would also likely fail because there would arguably be no fraudulent or material misrepresentation.<sup>381</sup>

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377. See Ben-Shahar & Schneider, *supra* note 94, at 738 (“[M]andated disclosure can undermine other consumer protections . . . [like] unconscionability . . .”); cf. Marotta-Wurgler, *Disclosure*, *supra* note 112, at 12 (“[C]ourts might mistakenly be led to believe that sellers’ terms are the product of well-functioning market mechanisms and be more lenient in policing abusive terms.”).
378. There are other contract policing doctrines whose efficacy would be unaffected by any type of disclosure, like duress and undue influence. See RESTATEMENT (SECOND) OF CONTRACTS §§ 175 (duress), 177 (undue influence) (1981). Unfortunately, these doctrines will generally be of little help to the individual because they are often unsuccessful when raised. My theory about why these traditional doctrines, like the other policing doctrines mentioned, are unsuccessful turns on the fact that (1) all of these doctrines are available only after the contract is formed in the first instance; see *supra* text accompanying notes 81–82; and, consequently, (2) they are all subject to a “process problem” that makes successfully raising any of these doctrines in litigation unlikely. See Hart, *supra* note 5, at 210–16 (discussing the “process problem” in detail); *supra* text accompanying notes 73–90; Grace M. Giesel, *A Realistic Proposal for the Contract Doctrine of Duress*, 107 W. VA. L. REV. 443, 463–65 (2005) (concluding, on the basis of an empirical study of duress cases, that because of the “conflict and confusion” surrounding the elements of duress, only a small fraction of duress claims are successful); Morant, *MLK*, *supra* note 40, at 110 (“The existence of regulatory devices [like] duress, unconscionability, and undue influence cannot . . . sufficiently accommodate marketplace inequities. The . . . dearth of cases where individuals are successful in obtaining relief through those devices substantiates this point. This result is compounded by the heavy burden of proof placed upon the claimant of such relief.”) (footnotes omitted). Cf. Larry A. DiMatteo & Bruce Louis Rich, *A Consent Theory of Unconscionability: An Empirical Study of Law in Action*, 33 FLA. ST. U. L. REV. 1067, 1097 (2006) (“Data revealed that in only 37.8% (56 out of 148) of the cases sampled unconscionability was found . . .”).
379. See *supra* note 107 (discussing Robert Summers’s interpretation of the good faith requirement as requiring disclosure). See generally Hough, *supra* note 107, at 1027–28 (containing a much more expansive interpretation of good faith).
380. See, e.g., RESTATEMENT (SECOND) OF CONTRACTS § 161 (1981) (when non-disclosure is equivalent to an assertion).
381. A contract claim for misrepresentation requires a fraudulent or material misrepresentation. See RESTATEMENT (SECOND) OF CONTRACTS § 164 (1981). By definition, a misrepresentation, whether fraudulent or material, presupposes that a

In all likelihood, an unconscionability<sup>382</sup> claim or defense would probably fail, again because of the disclosure of the term. Under these circumstances, there is no “unfair surprise” and, therefore, arguably, no procedural unconscionability.<sup>383</sup> Indeed, the argument stated more particularly would be that *there was compliance with the disclosure statute* and, as a result, there simply can be no procedural unconscionability.<sup>384</sup> The party raising unconscionability either as a claim or defense usually must prove both procedural and substantive unconscionability to prevail.<sup>385</sup>

In short, compliance with disclosure statutes only serves to strengthen the presumption of contract validity by making it appear that the quality of the weaker party’s mutual assent has increased and by ruling out the application of several contract policing doctrines. By strengthening the presumption of contract validity, these outcomes (1) simultaneously create systemic incentives for the party with more bargaining power to impose even more onerous or one-sided terms during contract formation;<sup>386</sup> and (2) increase the power

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“false” statement is being made. *See* BLACK’S LAW DICTIONARY (9th ed. 2009). Actual compliance with a disclosure statute would preclude a false statement in the disclosures made. Recall also that there is no duty on the part of a lender, for example, to disclose whether borrowers actually qualify for the loans they are sold. *See supra* text accompanying notes 306–11.

382. *See* RESTatement (SECOND) OF CONTRACTS § 208 (1981) (unconscionable contract or term); U.C.C. § 2-302 (2011) (unconscionable contract or clause).
383. Cf. Robert A. Hillman, *On-Line Boilerplate: Would Mandatory Website Disclosure of E-Standard Terms Backfire?*, 104 MICH. L. REV. 837, 840, 853 (2006) (making the same argument regarding unconscionability in the context of on-line contracting).
384. According to U.S. DEP’T OF HOUS. & URB. DEV. & U.S. DEP’T OF TREASURY, RECOMMENDATIONS TO CURB PREDATORY HOME MORTGAGE LENDING 67 (2000), available at <http://www.huduser.org/publications/pdf/treasrpt.pdf>, “The fact is that written disclosure requirements, without other protections, can have the unintended effect of insulating predatory lenders where fraud or deception may have occurred.”
385. *See, e.g.*, A & M Produce Co. v. FMC Corp., 186 Cal. Rptr. 114, 121–22 (Cal. Ct. App. 1982); Leff, *supra* note 108, at 487–88. *But see* Gillman v. Chase Manhattan Bank, 534 N.E.2d 824, 829 (N.Y. 1998) (“While determinations of unconscionability are ordinarily based on the court’s conclusion that both the procedural and substantive components are present, there have been exceptional cases where a provision of the contract is so outrageous as to warrant holding it unenforceable on the ground of substantive unconscionability alone.”) (citations omitted); State v. Wolowitz, 468 N.Y.S.2d 131, 145 (N.Y. App. Div. 1983) (“While there may be extreme cases where a contractual term is so outrageous and oppressive as to warrant a finding of unconscionability irrespective of the contract formation process (see, e.g., Jones v. Star Credit Corp., 298 N.Y.S.2d 264 266–67 (Sup. Ct. 1969)), such cases are the exception.”).
386. This is because any subsequent challenge to the validity of the terms added during formation will likely fail.

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of that stronger contracting party by effectively immunizing the exercise of that bargaining power during contract formation from subsequent challenge (i.e., by eliminating several contract policing doctrines).<sup>387</sup> In the hypothetical subprime loan transaction between CitiMortgage and Mary Smith,<sup>388</sup> for example, it could be argued that CitiMortgage was incentivized to impose the onerous terms (high origination and post-origination fees, the prepayment penalty clause, and high interest rate)<sup>389</sup> on Mary Smith because it could do so with little risk of liability.<sup>390</sup>

One could argue in response to the hypothetical in general that using a subprime mortgage loan is the wrong example.<sup>391</sup> The real problem is not the subprime loan, but rather that the American financial market crashed.<sup>392</sup> Both parties—CitiMortgage *and* Mary Smith—ended up doing very badly as a result of it. While this

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387. See *supra* text accompanying notes 366–72. See generally Hart, *supra* note 5.

388. See *supra* text accompanying notes 16–30.

389. See *supra* text accompanying notes 26–30.

390. There is low risk of liability to CitiMortgage because of compliance with the disclosure statutes and the presumption of contract validity.

391. One could also argue that using a subprime mortgage loan is the wrong example because it involves a very complex transaction where the inequality of bargaining power between the parties is stark. As a result, the subprime loan example presents the “too easy” case, that is, the type of case that would obviously expose flaws in the modern contract law system. While I agree that a subprime loan contract is extremely complex, I disagree that it is the wrong example.

The subprime mortgage loan was chosen precisely because it is a problematic transaction on its face—the unequal bargaining power and unfair terms seem apparent. This is exactly the type of contract that one would think contract law would be well equipped to deal with, precisely because it is so obviously problematic. One of the main points this article tries to drive home, however, is that the modern contract law system is not set up to deal effectively with this kind of contract even though it is one that most people would likely agree is troubling. If contract law cannot even deal effectively with this kind of contract, then the likelihood that it will be able to deal well with contracts that are not as obviously problematic, but which nevertheless present issues with which contract law should be concerned, is greatly diminished.

The subprime loan was also chosen because it involves disclosure statutes. Another main argument made in this article is that disclosure statutes do not work, but they give the appearance that something is being done to address a specific problem in contracting. Because something is being done, no further inquiry is made. As a result, other very real problems get glossed over, specifically, racial and gender bias. The subprime loan example allows me to make this important point. *See infra* Part III.C.

392. In fact, this is exactly the argument Professor Victor Goldberg made in response to my presentation based on this article at the Spring Contracts Conference held at the William S. Boyd School of Law, at the University of Nevada, Las Vegas, in February.

general statement is correct, it misses the main thrust of this article's analysis and critique of modern contract law. To see the flaw, one need only consider the implications of the transaction for both parties with and without the financial market crash.

Prior to the financial market crash, CitiMortgage sold Mary Smith a loan that she did not qualify for and on terms that dramatically increased its profits on the loan.<sup>393</sup> Absent the financial market crash, CitiMortgage would have made a lot of money on its contract with Mary Smith to Mary Smith's detriment. CitiMortgage, therefore, ran into trouble *only* because the financial market crashed, not because of the subprime loan it sold to Mary Smith.<sup>394</sup>

Mary Smith, on the other hand, would have still been at the wrong end of a very bad bargain, regardless of whether the financial market crashed or not. She was sold a loan she did not qualify for and on very bad terms, ones that she could not afford.<sup>395</sup> The crux of Mary Smith's problem, therefore, stems from the subprime loan contract itself.<sup>396</sup> This is because the presumption of contract validity springs into existence immediately upon contract formation, and the burden of rebutting the presumption is imposed on the weaker contracting party,<sup>397</sup> here, Mary Smith. Given that it is extremely difficult to

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393. *See supra* text accompanying notes 16–30 (laying out the hypothetical).

394. Former Citigroup chief executive officer Charles Prince and former chairman of the board Robert Rubin admitted as much in recent testimony before the Financial Crisis Inquiry Commission. Mr. Prince stated, "I'm sorry that our management team, starting with me, like so many others, could not see the unprecedented market collapse that lay before us." Mr. Rubin testified in a similar vein when he stated that, "[a]ll most of us in the financial system — including financial firms, regulators, rating agencies, analysts and commentators — missed the powerful combination of forces at work and the serious possibility of a massive crisis" and, "We all bear responsibility for not recognizing this, and I deeply regret that." Jim Puzzanghera, *Two Former Top Citigroup Executives Apologize for Crisis and Bailout*, L.A. TIMES (Apr. 9, 2010), <http://articles.latimes.com/print/2010/apr/09/business/la-fi-citi-bailout9-2010apr09>.

395. *See supra* text accompanying notes 26–30 (terms of the loan).

396. In fact, regardless of whether the market rose, stayed the same, or crashed, Mary Smith was sold a mortgage loan on very bad terms. So even if the market rose and Ms. Smith was able to refinance her house, she would still be worse off as a result of her loan with CitiMortgage than she would have been had she not been sold a loan on such bad terms. The focus on the housing market crash, therefore, is simply misplaced. The real problem is the unfairness of the subprime loan contract between CitiMortgage and Mary Smith. *See supra* note 26 and accompanying text (suggesting that the high prepayment penalty in Mary Smith's subprime loan could have made it prohibitively expensive to refinance out of her loan with CitiMortgage at all, let alone prior to CitiMortgage's upward adjustment of its adjustable rate mortgages).

397. *See* Hart, *supra* note 5, at 204–16; *supra* text accompanying notes 73–74.

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overcome the presumption of contract validity in practice,<sup>398</sup> *any* terms (reasonable or unreasonable) imposed by the party with more bargaining power (CitiMortgage) during contract formation would likely be deemed valid and enforceable in any subsequent dispute between the two contracting parties.<sup>399</sup> The contract, in other words, would be binding and Mary Smith would be stuck with her very bad bargain with CitiMortgage, regardless of the financial market crash and whether CitiMortgage kept the loan itself or sold it to another entity.

Ironically, instead of protecting the rights of someone like Mary Smith, the weaker contracting party, compliance with disclosure statutes will actually undermine them<sup>400</sup> in favor of CitiMortgage, the party with more bargaining power. Significantly, CitiMortgage's abuse of its superior bargaining power will probably remain hidden because the process problem<sup>401</sup> will either prevent a challenge to these subprime mortgages from going to court in the first instance<sup>402</sup> or will cause most of the challenges that do make it through the courthouse doors to fail.<sup>403</sup> This is at least in part because the already enormous costs of litigation would be compounded by choice of forum clauses that would likely require litigation in a foreign state;<sup>404</sup> choice of law clauses usually adopt the law of a non-consumer friendly state to resolve the dispute;<sup>405</sup> and, of course, modern contract law's solutions, namely, the contract policing and defense to

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398. See *supra* text accompanying notes 72–82. See generally Hart, *supra* note 5, at 210–16.

399. In fact, it has already been established that subprime loans are enforceable. See *supra* text accompanying notes 238–40.

400. Hillman, *supra* note 383, at 853–55.

401. See *supra* text accompanying notes 72–82.

402. Mandatory arbitration provisions would also prevent challenges to subprime mortgages from getting into court. Many, if not most, of the subprime loan contracts include such provisions. See, e.g., *Civil Rights Groups Commend Freddie Mac's Leadership in Banning Mandatory Arbitration Clauses*, CTR. FOR RESPONSIBLE LENDING (Dec. 9, 2003), <http://www.responsiblelending.org/media-center/press-releases/archives/groups-commend-freddie-mac-ban-on-mandatory-arbitration.html> (“In recent years, the inclusion of mandatory arbitration language in subprime mortgage contracts has become increasingly common. . . . The increasing inclusion of mandatory arbitration clauses in subprime home loans without the borrower’s knowledge has been especially pernicious, disproportionately affecting seniors, low-income, African-American and other minority families.”); Salley v. Option One Mortg. Corp., 246 F. App’x 87, 90 (3d Cir. 2007) (holding that the arbitration clause in a subprime mortgage contract was not unconscionable).

403. C.f. Hart, *supra* note 5, at 214–15.

404. Hart, *supra* note 5, at 215 n.218.

405. *Id.* n.219.

performance doctrines, would be ineffective or unavailable in most cases to resolve the problem.<sup>406</sup> As a result, CitiMortgage's abuse of its unequal bargaining power would also go unaddressed. Unequal bargaining power is thereby institutionalized in the modern contract law system, and, as a consequence, the system effectively permits the party with more bargaining power (CitiMortgage), if it so chooses, to impose bad bargains on its contracting partners (e.g., Mary Smith) with impunity.

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406. The contract policing doctrines would be ineffective in most cases to resolve the unequal bargaining problem because (a) disclosure pursuant to the disclosure statutes could rule out the application of several contract policing doctrines entirely, see *supra* text accompanying notes 365–72 (discussing the policing doctrines potentially affected); (b) the contract policing doctrines are not generally successful when they are raised, see DiMatteo & Rich, *supra* note 378, at 1097 (“Data revealed that in only 37.8% (56 out of 148) of the cases sampled unconscionability was found.”); see also Giesel, *supra* note 378, at 463–65 (examining published state cases from 1996 through 2003 and finding that in “only nine of the eighty-eight [duress] cases did the court decide the matter in favor of the duress claim,” of those nine cases, an appellate court affirmed a lower court’s finding of duress in only two cases); and (c) the difficulty in rebutting the presumption of contract validity in practice means that most cases will likely lose in court, see *supra* text accompanying notes 73–82 (discussing the difficulty of rebutting the presumption of contract validity). The defense-to-performance doctrines include impracticability of performance and frustration of purpose. See RESTATEMENT (SECOND) OF CONTRACTS §§ 261, 265 (1981). It is black letter contract law that changes in a market do not affect the basic assumption on which contracts are made. Consequently, the second element of both claims would fail and Mary Smith would be unable to establish a claim or defense based on either of these doctrines. *Karl Wendt Farm Equip. Co. v. Int’l Harvester Co.*, 931 F.2d 1112, 1117–18 (6th Cir. 1991) (“While the facts suggest that [International Harvester] suffered severely from the downturn in the farm equipment market, neither market shifts nor the financial inability of one of the parties changes the basic assumptions of the contract such that it may be excused under the doctrine of impracticability.”); *In re F. Yeager Bridge & Culvert Co.*, 389 N.W.2d 99, 104 (Mich. Ct. App. 1986) (“In Toebe’s litigation with the state, Toebe’s claim of impossibility was ostensibly grounded upon common law principles, under which mere changes in marketing conditions which render performance unprofitable do not justify releasing a party from its obligation to perform.”); *Milligan v. Haggerty*, 295 N.W. 560, 563 (Mich. 1941) (“Nor is there merit to defendants’ claim that the lessee was released from performing his contract by reason of the fact that under subsequent market conditions it became unprofitable for him to manufacture bricks from the clay on the leased premises.”); see also RESTATEMENT (SECOND) OF CONTRACTS § 261 cmt. b (1981). (“The continuation of existing market conditions and of the financial situation of the parties are ordinarily not such assumptions, so that mere market shifts or financial inability do not usually effect discharge under the rule stated in this Section.”). The same would be true for the doctrines of mistake. *Pub. Util. Dist. No. 1 v. Washington Pub. Power Supply Sys.*, 705 P.2d 1195, 1203 (Wash. 1985) (en banc) *modified*, 713 P.2d 1109 (Wash. 1986) (“[S]hifts in market conditions or financial ability do not justify avoidance under the rules governing mistake.”).

### C. Smoke and Mirrors

Power is ubiquitous; it exists everywhere.<sup>407</sup> This is not an original conclusion. The Legal Realists,<sup>408</sup> Critical Legal Studies,<sup>409</sup> feminism,<sup>410</sup> and more “other-oriented” social justice theories such as Critical Race Theory<sup>411</sup> and Queer Legal Theory<sup>412</sup> exposed it. Thus, it is not at all surprising that power is also present in modern contract law. What is surprising is that the systemic and structural role state power plays in contract law is not acknowledged or discussed.<sup>413</sup> This omission is especially surprising given that the modern contract law system adopts the premise that contracts are made binding as a cardinal principal, continues to adhere to a framework that is constructed on assumptions that cannot be sustained,<sup>414</sup> and institutionalizes unequal bargaining power.<sup>415</sup> Constructing the system in this fashion comes with unacknowledged costs. Specifically, such a system not only reifies pre-existing distributions and power imbalances, but also exacerbates and ultimately obscures them to the ultimate detriment of parties with less bargaining power. Modern contract’s formation rules and disclosure statutes play an important role in this obfuscatory process.

To begin with, disclosure statutes presuppose that the main problem confronting contracting parties is bargaining inequality in the form of access to and possession of information.<sup>416</sup> In so doing,

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- 407. Barnhizer, *Inequality*, *supra* note 15, at 142 (“[P]ower is omnipresent in human relations—every actor has power of some kind and to some degree.”).
  - 408. See *supra* Part II.A.1-2.
  - 409. See *supra* note 239 (discussing “all law is politics”).
  - 410. See, e.g., SIMONE DE BEAUVOIR, THE SECOND SEX (H.M. Parshley ed., Alfred A. Knopf trans.1993) (1949); CATHARINE A. MACKINNON, TOWARD A FEMINIST THEORY OF THE STATE (1989).
  - 411. See, e.g., IAN F. HANEY LOPEZ, WHITE BY LAW: THE LEGAL CONSTRUCTION OF RACE (1996); Kimberle Williams Crenshaw, *Race, Reform, and Retrenchment: Transformation and Legitimation in Antidiscrimination Law*, 101 HARV. L. REV. 1331 (1988); Cheryl I. Harris, *Whiteness as Property*, 106 HARV. L.REV. 1709 (1993).
  - 412. See, e.g., Francisco Valdez, *Queers, Sissies, Dykes, and Tomboys: Deconstructing the Conflation of “Sex,” “Gender,” and “Sexual Orientation” in Euro-American Law and Society*, 83 CAL. L. REV. 1 (1995).
  - 413. See Barnhizer, *Inequality*, *supra* note 15, at 141 (“American contract law rarely acknowledges power explicitly . . . ”).
  - 414. See *supra* Part II.A.
  - 415. See *supra* Part III.B.
  - 416. See Ben-Shahar & Schneider, *supra* note 94, at 720 (“[M]andated disclosure is fundamentally misconceived because its solution to the problem of choice is information alone. But people’s problems choosing go well beyond ignorance.”); Willis, *supra* note 26, at 743 (“The disclosure regime admits of some boundedness to

disclosure statutes obscure other more problematic forms of bargaining inequality, forms that were clearly present in the CitiMortgage–Mary Smith hypothetical and in the subprime mortgage market in general, such as racial and gender bias.<sup>417</sup>

As discussed earlier, use of disclosure statutes may also prevent many contracts from being successfully challenged based on several of the modern contract policing doctrines.<sup>418</sup> By obscuring the existence of other contracting problems and rendering several of the contract policing doctrines ineffective, therefore, disclosure statutes help mask the power imbalance embedded in the modern contract law system.<sup>419</sup>

Significantly, disclosure statutes also operate as a safety valve for the modern contract law system. They show that a problem has been identified (i.e., bargaining inequalities in the form of information asymmetries) and, more importantly, that *something* is being done to address it.<sup>420</sup> That this something (i.e., disclosure statutes) does not work very effectively is generally ignored,<sup>421</sup> and, quite frankly, is largely beside the point.<sup>422</sup> The point is that *something* is being done.

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consumer rationality . . . but concludes that the main correction the market needs is informational.”); *supra* text accompanying notes 111–14.

417. See, e.g., Ian Ayres, *Fair Driving: Gender & Race Discrimination in Retail Car Negotiations*, 104 HARV. L. REV. 817, 817 (1991) (discussing race and gender bias in the retail car market); Ian Ayres, *Further Evidence of Discrimination in New Car Negotiations and Estimates of Its Cause*, 94 MICH. L. REV. 109, 109 (1995) (confirming the same findings of racial and gender bias in the retail car market); Hosea H. Harvey, Coercion or Choice in Conspicuous Markets: An Applied Analysis 46 (gathering empirical research documenting racial bias in professional sports markets (e.g., the NBA)) (on file with the author); *supra* notes 22–23 (citing studies finding that women of color were disproportionately sold subprime loans).
418. See *supra* text accompanying notes 377–87.
419. Cf. Marotta-Wurgler, *Disclosure*, *supra* note 112, at 31 (“[A] policy concern . . . is that the mere existence of disclosure regimes might lead courts to believe that market mechanisms indeed work, and thus to give insufficient attention to the potential for abusive terms.”).
420. In an analogous context, Hillman writes that “disclosure is cheap, substantiates the claim of consumer assent, and constitutes a symbolic victory for those advocating greater fairness in e-standard form contracting.” Hillman, *Boilerplate*, *supra* note 383, at 855.
421. See Ben-Shahar & Schneider, *supra* note 94, at 682–84 (explaining that there are few critics of mandatory disclosure); Willis, *supra* note 26, at 39 (“The optimism of some academics that a middle ground can be found for disclosures that neither under- nor over-deter risky but frequently socially desirable behavior is misplaced; the bimodal, poorly-calibrated behavioral response of most of the population to risk is well-established, and no warning will change that.”) (footnote omitted).
422. Cf. Ben-Shahar & Schneider, *supra* note 94, at 682 (“[M]andated disclosure looks effective.”).

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Disclosure statutes, therefore, provide a visible but ineffective fix for very real contracting problems; in so doing, disclosure statutes diffuse the call or drive for alternative ways, like substantive regulation or maybe even market-based solutions,<sup>423</sup> to address problems in contracting.<sup>424</sup> The modern contract law system is therefore able to alleviate pressure on itself by providing a quick fix, which, in turn, enables the system as a whole to continue unexamined and unchecked.<sup>425</sup> Hence, disclosure statutes create a very effective smoke screen for modern contract law. They justify the (ab)use of power by the party with superior bargaining power both by masking the power imbalance embedded in the very structure of modern contract law and diverting critical attention and analysis away from that structure as a whole.

The end result is that the modern contract law system permits if not encourages the (mis)use of power by parties with more bargaining power, which, in turn, serves to reify and exacerbate pre-existing distributions and power imbalances.<sup>426</sup> A final look at the CitiMortgage–Mary Smith hypothetical will illustrate these last points.

The (mis)use of power in the hypothetical is easy to spot—in a context that smacks of race and gender bias,<sup>427</sup> CitiMortgage sold Mary Smith a loan with terms that unreasonably favored it and that modern contract law will likely enforce.<sup>428</sup> CitiMortgage’s superior bargaining power was thereby increased (even if incrementally) because it was able to extract more gains from its contract with Mary Smith than it otherwise would if it either had less bargaining power

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423. See Ben-Shahar, *Myth*, *supra* note 131, at 21–26 (suggesting rating of contracts and labeling as possible market mechanisms “to provide some degree of informed-ness”).

424. See Hillman, *Boilerplate*, *supra* note 383, at 23 (“[D]isclosure . . . may inadvertently . . . forestall other attempts at reform.”); Ben-Shahar, *Myth*, *supra* note 131, at 6 (“[T]he presumption of assent that accompanies pre-disclosed terms assuages the need to develop other protections.”); Ben-Shahar & Schneider, *supra* note 94, at 740 (“Mandated disclosure may not only undermine other protections, but also inhibit their development.”); Marotta-Wurgler, *Disclosure*, *supra* note 112, at 6 (“[C]ourts might be led to mistakenly believe that sellers’ terms are the product of well-functioning market mechanisms and be more lenient in policing abusive terms.”).

425. See *supra* text accompanying notes 282–84 (discussing the rational actor assumption and the use of disclosure statutes to re-legitimate that assumption).

426. See generally *supra* Part III.A (discussing the synergism).

427. See *supra* notes 22–23 (citing studies finding that women of color were disproportionately sold subprime loans).

428. See generally *supra* notes 16–33 and accompanying text (discussing the CitiMortgage–Mary Smith hypothetical and binding contracts).

or was unable to capitalize on it. Its ability to (ab)use its superior bargaining power was then reified in its transaction with Mary Smith because the subprime mortgage loan would most likely be binding. Because the contract would likely be made binding, CitiMortgage is able to retain the benefits from its subprime loan with Mary Smith and all of its other subprime loans. Retention of the gains from its subprime loans means CitiMortgage ends up owning more resources (i.e., money in this example) over time, which, in turn, further increases CitiMortgage's unequal bargaining power.<sup>429</sup>

Significantly, modern contract law, particularly its formation rules, legitimizes this (ab)use of power by CitiMortgage by providing a veneer of voluntariness. Because a contract is by the modern contract law system's understanding an act of free will (autonomy) one must "agree" to be bound. This notion of voluntariness is underscored by the existence of the disclosure statutes (TILA and RESPA) because Mary Smith (the party in need of the disclosures) has been given all the salient information necessary to make an informed decision about whether to enter into the loan contract with CitiMortgage.

In fact, however, modern contract's formation rules and disclosure statutes work together to reinforce (and re-legitimate) the modern contract law assumptions that contracts are a product of voluntary and informed choice *and* obfuscate the (ab)use of power actually taking place. In so doing, modern contract law also reaffirms and re-legitimizes its assumption that unequal bargaining power exists but only in an unproblematic way.<sup>430</sup> Because the existence, (ab)use and (mis)use of power within the system is obscured, the modern contract law system is largely successful in its re-legitimation effort.

On the surface, therefore, modern contract law's framework appears intact—the system once again proves to be self-legitimizing. That system, however, ends up diminishing freedom and liberty. This result should be deeply troubling for contract scholars and others who believe that freedom and individualism are best represented in the freedom of contract ideal.

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429. This is because the contract is likely to be made binding, which means it was validly formed and is enforceable. It is important to note here that the scheme for this particular loan transaction is one in which the contract was regulated (TILA and RESPA) in a way that is supposed to help protect the consumer. Imagine if this was in an area with no consumer protection regulation.

430. See *supra* text accompanying notes 91–101.

## CONCLUSION

We could certainly pretend things are different in the world of contracts. Pretending would actually be quite easy because all we would have to do is continue to subscribe to the current understanding of modern contract law. Or we could just continue to claim that the modern contract law system is efficient or serves individual autonomy well. Of course, to do any of these things, we would have to ignore that all of the assumptions underlying the modern contract law system are deeply flawed in theory and practice. We would also have to ignore the practical implications, if not actual, adverse consequences, that modern contract law imposes on contracting parties, especially those with less bargaining power.

The alternative is to be honest and acknowledge that modern contract law is premised on power, and, therefore, it is not neutral and does not produce neutral results, notwithstanding the perpetual myth that the law should be and do just that.<sup>431</sup> If we adopted this understanding, we could then acknowledge that contracts are made binding as an exercise of state power and that, as a direct result, unequal bargaining power becomes a systemic and structural component of the system. We would then be able to stop pretending, for example, that contracts are voluntary, informed, and a product of rational actor decision-making.

Under this alternative view of modern contract law, most contracts could and probably would still be binding. But we could, at the very least, discuss the normative questions about the role of power in the contract law system—*should it* be constrained, and if so, how? *If there is agreement* that power in contracting should be constrained, we could then contemplate rules that grapple with power per se rather

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431. Samuel J. Astorino, *The Transformation Thesis of Morton J. Horwitz: Research Problems and Implications for the Practice of Liberal Democracy*, 36 DUQ. L. REV. 1, 6 (1997) (“Law is neutral, therefore, and nonpolitical, because legal reasoning does not, and should not, react to external social forces.”); Susan S. Kuo, *Culture Clash: Teaching Cultural Defenses in the Criminal Law Classroom*, 48 ST. LOUIS U. L.J. 1297, 1298 (2004) (“By legally parsing facts, they learn to siphon off the emotional and cultural content—both in the stories themselves and in their reactions to the stories. The language of the law commands that they do this because of the enduring belief that the law is neutral and impartial.”) (footnote omitted); Adele M. Morrison, *Queering Domestic Violence to “Straighten Out” Criminal Law: What Might Happen When Queer Theory and Practice Meet Criminal Law’s Conventional Responses to Domestic Violence*, 13 S. CAL. REV. L. & WOMEN’S STUD. 81, 103 (2003) (“This idea that the law is neutral, unbiased and equally applied regardless of status or identity permeates the legal system.”).

than continue to wrestle with legal fictions. For example, we could seriously consider the viability of a veil of ignorance analysis to determine fair terms.<sup>432</sup> We could consider constructing and adopting a bargaining power analysis.<sup>433</sup> We could contemplate new interpretations of existing contract doctrines, like good faith,<sup>434</sup> or think about reviving the late Professor Richard Speidel's proposal to constrain the use of standard forms involving non-merchants in a sale-of-goods transaction.<sup>435</sup> Or, more radically, we could consider, as some have suggested, getting rid of mutual assent entirely.<sup>436</sup>

Obviously, adopting any such rules would require a rigorous normative analysis that incorporates more than a mere assessment of their costs and benefits.<sup>437</sup> Such an analysis is outside the scope of this particular article. Moreover, it is also clear that any solution proposed would be subject to the very critiques this article has leveled at the modern contract law system.<sup>438</sup> That the solutions are imperfect and subject to critique, however, should not and does not prevent their consideration or adoption. We live in an imperfect world in which the uneven distribution of power is a fact of life. We nevertheless have to move forward in a way that is "consistent with minimum standards for social and economic relationships in a free and democratic society."<sup>439</sup> Perhaps contract law has a role to play in

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- 432. See Singer, *Standards*, *supra* note 142, at 142 (suggesting a veil of ignorance analysis).
  - 433. See Barnhizer, *Inequality*, *supra* note 15, at 223–34 (suggesting a bargaining power analysis); Miller, *supra* note 54, at 531–35 (suggesting a sophisticated party analysis).
  - 434. Hough, *supra* note 107 (advocating for use by courts of the doctrine of good faith as a device to eliminate racial subordination); Amy J. Schmitz, *Confronting ADR Agreements' Contract/No Contract Conundrum With Good Faith*, 56 DEPAUL L. REV. 55 (2006) (advocating for the use of the doctrine of good faith to fill in gaps in ADR agreements).
  - 435. See Richard E. Speidel, *Revising UCC Article 2: A View from the Trenches*, 52 HASTINGS L. J. 607, 615 (2001) (suggesting revisions to UCC §§ 2-206, 2-207 such that "the presence of a standard form or term signaled the risk of unfair surprise," which therefore required the party using the standard form or term to get the other party's express agreement or risk having the terms excluded from the contract).
  - 436. See Omri Ben-Shahar, *Contracts Without Consent: Exploring A New Basis for Contractual Liability*, 152 U. PA. L. REV. 1829 (2004) (suggesting that a no-retraction principle replace the doctrine of mutual assent).
  - 437. Joseph W. Singer, *Normative Methods for Lawyers*, 56 UCLA L. REV. 899 (2009) [hereinafter Singer, *Normative*] (discussing normative argumentation and how lawyers can defend claims of equality and justice).
  - 438. See Barnhizer, *Bargaining Power*, *supra* note 94, at 147 (2007) ("Because power is so complex and so dynamic . . . bargaining power subdoctrines will always be subject to criticism of incoherency and indeterminacy."); *supra* Parts II–III.
  - 439. Singer, *Normative*, *supra* note 437, at 899.

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this discussion. By acknowledging the existence, role, and consequences of power in the modern contract law system, therefore, we at least free ourselves to debate *all* of these issues and solutions frankly.

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