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## Smoke, Mirrors & Contract Law

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**Smoke, Mirrors and Contract Law**

**DANIELLE KIE HART\***

*Abstract: Contract law is set up to be transaction enforcing, that is, to be binding. Binding means two different but related things. 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 over the objection of the other, now resisting party. Modern contract law uses several well-established assumptions about the contracting parties, including the way they behave when contracting, and the roles of the market and state, to justify binding people to their contracts. The problem with making contracts binding, however, is that all of the assumptions are wrong both theoretically and in practice. They are wrong in theory as the work of the Legal Realists, Critical Legal Studies scholars, relational contract theorists and, more recently, behavioral law and economics scholars show. They are also wrong in practice as an examination of a subprime mortgage loan hypothetical, one that implicates disclosure statutes, will demonstrate. Because the assumptions are wrong, 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. Contract law’s formation rules and disclosure statutes help justify this grant of power by masking the power imbalance embedded in the modern contract law system and by diverting critical attention and analysis away from that system as a whole. As a result, making contracts binding comes with unacknowledged costs, all of which work to the detriment of parties with less bargaining power, regardless of whether they are individuals or business entities. Specifically, the extent of state power that actually exists within the modern contract law system and its uses are concealed. As a specific consequence, unequal bargaining power becomes institutionalized within the system such that the party with superior bargaining power can, if it so chooses, impose bad bargains on its contracting partners with impunity. Exploring the premise that contracts are made*

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*Smoke, Mirrors & Contract Law*

*binding thus allows us to see the powerful role that the state plays in creating and maintaining a deeply flawed contract law system, one in which imbalances of power, not freedom and consent, are the hallmark. These imbalances are so deeply embedded that even mediocre remedial efforts, like disclosure statutes, reify rather than mitigate them. This result should be troubling for contract scholars and others who adhere to the notion that freedom and individuality are epitomized in the freedom of contract ideal.*

**Introduction..... 2**  
**II. Binding Contracts ..... 10**  
    A. The Modern Contract Law System ..... 10  
    B. Disclosure Statutes as a Modern Contract Remedial  
        Tool ..... 20  
**III. Contracts and State Power ..... 25**  
    A. The Assumptions in Theory and in Practice. .... 25  
        1. *The Market is Not Self-Regulating or Largely Outside*  
           *of State Control*..... 25  
        2. *Contracts Are Not Voluntary* ..... 32  
        3. *Contracts Are Public, Not Private*..... 36  
        4. *The State's Role is Neither Nor Minimal and,*  
           *Therefore, Contracts Are Not Just Between Two*  
           *Private Parties* ..... 38  
        5. *Individuals Do Not Act Rationally in the Marketplace,*  
           *Nor Are Contracts the Product of Informed Choice*..... 38  
        6. *Parties Do Not Bargain At Arm's-Length and They*  
           *Are Not Most Likely Strangers to One Another*..... 43  
    B. The Universe of Contracts..... 48  
**IV. Contracts and Unequal Bargaining Power ..... 52**  
    A. Synergy: State Power and Unequal Bargaining Power..... 53  
    B. Institutionalizing Unequal Bargaining Power ..... 54  
    C. Smoke and Mirrors..... 60  
**V. Conclusion..... 63**

**Introduction**

Contracts are believed to be private transactions between private parties that promote autonomy,<sup>1</sup> efficiency,<sup>2</sup> utility, or other norms. But contracts actually further the exercise of

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<sup>1</sup> Wayne Barnes, *The Objective Theory of Contracts*, 76 U. Cin. L. Rev. 1119, 1129 (2008); Peter A. Alces & Jason M. Hopkins, *Carrying a Good Joke Too Far*, 83 Chi.-Kent L. Rev. 879, 906 (2008); Nancy S. Kim, *Clicking and Cringing*, 86 Or. L. Rev. 797, 801 (2007); Joseph William Singer, *Legal Realism Now*, 76 Cal. L. Rev.

## *Smoke, Mirrors & Contract Law*

power both by the state and individual parties, because of the way that the modern contract law system<sup>3</sup> is set up.

This Article<sup>4</sup> uses the instrument of disclosure statutes to expose the power hidden in the modern contract law system. Ironically, these statutes are usually thought to mitigate imbalances of power when, in fact, they exacerbate them. The arguments developed in the Article rely on the following hypothetical involving a subprime home mortgage loan,<sup>5</sup> one in which disclosure statutes are implicated. The specific statutes include the Truth in Lending Act (TILA)<sup>6</sup> and the Real Estate Settlement Procedures Act (RESPA).<sup>7</sup>

The lender in the hypothetical is CitiMortgage. CitiMortgage was chosen because it is a mortgage company<sup>8</sup> and a subsidiary of Citigroup, Inc.;<sup>9</sup> it was also one of the biggest subprime mortgage lenders in the country.<sup>10</sup> The borrower is Mary Smith, a 32 year old, single, African

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465, 484 (1988).

<sup>2</sup> See, e.g., Alan M. White, Behavior and Contract, 27 *Law & Ineq.* 135, 137 (2009); Larry A. DiMatteo, The History of Natural Law Theory: Transforming Embedded Influences Into a Fuller Understanding of Modern Contract Law, 60 *U. Pitt. L. Rev.* 839, 885 (1999).

<sup>3</sup> 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 the rules. See *infra* text accompanying notes 61-68 (for a discussion of the underlying assumptions). The context in the Article should make it clear whether the rules, norm(s) and/or assumptions are being discussed.

<sup>4</sup> This Article is the second part of a five part contract theory project in which I: (a) identify what I see as potential problems with the modern contract law system or at least disconnects between the way contract law is talked about in contract casebooks and in cases; (b) develop a theory of the social construction of power to explain the existence, extent and role of power in modern contract law (parts 3 & 4); and, of course, (c) suggest some solutions to the problems identified (part 5). This project and the ideas and arguments contained in it are therefore very much works in progress. As such, I expect the ideas and arguments to change and develop over time and in response to any discussion that the project may evoke.

<sup>5</sup> An accepted definition of a “subprime loan” is one with an 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).

<sup>6</sup> 15 U.S.C. §§1601-1615, 1631-49, 1661, 1667(f) (2000 & Supp. II 2004) (implemented by the Federal Reserve Board via Regulation Z, 12 C.F.R. §226 (2005)).

<sup>7</sup> 12 U.S.C. §§2601-2617 (2000) (implemented by the Dep’t of Hous. & Urban Dev., 24 C.F.R. §§3500, 3800).

<sup>8</sup> Mortgage companies, as opposed to depository institutions, like a bank, were responsible for originating the bulk of subprime loans. Bar-Gill, *supra* note 5, at 1090.

<sup>9</sup> This information was taken from the Citi website: <http://www.citigroup.com/citi/business/brands.htm>. (last visited on March 11, 2010).

<sup>10</sup> 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* (2007) (the market shares of the top subprime lenders in 2006 were: 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

*Smoke, Mirrors & Contract Law*

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>11</sup> African American women were disproportionately represented among this demographic.<sup>12</sup>

In 2006, CitiMortgage sold Ms. Smith a subprime loan to purchase a single-family residence<sup>13</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>14</sup> Some of the terms included in the loan were a high prepayment penalty provision,<sup>15</sup> very

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80.5% of the market). (available at <http://www.recharts.com/reports/CSHB031207/CSHB031207.pdf>)

<sup>11</sup> Allen J. Fishbein & Patrick Woodall, *Women Are Prime Targets for Subprime Lending: Women are Disproportionately Represented in High-Cost Mortgage Market*, Consumer Federation of America (December 2006) (finding that women, particularly African American and Latino women, were more likely to receive subprime mortgages than men.) (available at:

<http://www.consumerfed.org/elements/www.consumerfed.org/file/housing/WomenPrimeTargetsStudy120606.pdf>);

accord, Consumers Union SWRO, “Women Pay More For Home Ownership” (October, 2002) (data from Texas)

(available at: <http://www.consumersunion.org/pdf/women-sub.pdf>); Mortgage Foreclosure Filings in Maryland, A

Study by The Reinvestment Fund for the Baltimore Homeownership Preservation Coalition (February, 2008)

(finding that African Americans living in predominantly African American neighborhoods received higher percentage of subprime loans than other racial categories and that most loans in foreclosure were obtained for home purchases rather than refinances) (available at:

<http://www.trfund.com/resource/downloads/policypubs/MarylandForeclosure.pdf>); Subprime Mortgage Lending in

the District of Columbia, A Study for the Department of Insurance, Securities and Banking (May, 2008) (finding

that subprime loans were disproportionately made to low income, African American borrowers) (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)); Manny

Fernandez, “Study Finds Disparities in Mortgages by Race,” *New York Times*, N.Y./Region, October 15, 2007

(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 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[.]” (available at: [http://www.nytimes.com/2007/10/15/nyregion/15subprime.html?\\_r=1](http://www.nytimes.com/2007/10/15/nyregion/15subprime.html?_r=1)).

<sup>12</sup> Fishbein & Woodall, *supra* note 11 (finding that women, particularly African American and Latino women, were more likely to receive subprime mortgages than men.); accord, Consumers Union SWRO, *supra* note 11 (data from Texas).

<sup>13</sup> In 2006, “42.4 percent of first-lien subprime loans were purchase loans.” Bar-Gill, *supra* note 5, at 1089.

<sup>14</sup> 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, *CROSSING THE LINE: PRIME, SUBPRIME, AND PREDATORY LENDING*, 61 *Maine L. Rev.* 287, 288 (2009). Lenders generally use several established criteria to determine whether a borrower qualifies for a home mortgage loan, including: 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 [FN33] and Freddie Mac [FN34] are allowed to purchase. “ Hull at 292; see also [http://www.incharge.org/Credit\\_Counseling/Resources/HomeOwnership/DoYouQualify.aspx](http://www.incharge.org/Credit_Counseling/Resources/HomeOwnership/DoYouQualify.aspx). 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 at 292; see also *supra* note 5 (definition of a 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.

high origination<sup>16</sup> and post-origination fees,<sup>17</sup> which totaled 20% of the loan amount,<sup>18</sup> and a 2/28 adjustable rate mortgage (ARM).<sup>19</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.

The crux of Mary Smith's problem is that she entered into a binding contract with CitiMortgage. Modern contract law is specifically set up to be transaction enforcing, that is, to make contracts binding.<sup>20</sup> "Binding" means two different but related things<sup>21</sup>--first, "binding"

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<sup>15</sup> A common feature of subprime loans was a steep prepayment penalty term. Estimates suggest that between 64% -98% of subprime loans included a prepayment penalty. Lauren E. Willis, *Decisionmaking and the Limits of Disclosure: The Problem of Predatory Lending*: Price, 65 Maryland L. Rev. 707, 763 (2006); see also Bar-Gill, *supra* note 5 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 *Subprime Mortgage Lending in the District of Columbia, A Study for the Department of Insurance, Securities and Banking*, *supra* note 11, at 2; C.f. 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 5, at 1102 ("Prepayment penalties make it more difficult for borrowers to evade the escalating payments.") To put this one term into some perspective, Bar-Gill writes:

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.

Bar-Gill, *supra* note 5, at 1101.

<sup>16</sup> Bar-Gill, *supra* note 5, at 1077 (Origination 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*, Harvard Law School Program on Risk Regulation, Research Paper No. 08-03 at 139 (according to the Wall Street Journal, "mortgage brokers received 27% higher fees for originating subprime mortgages than for originating conforming loans.")

<sup>17</sup> Bar-Gill, *supra* note 5, at 1077 (Post-origination fees include: "late fees, foreclosure fees . . . and dispute-resolution or arbitration fees.")

<sup>18</sup> Bar-Gill, *supra* note 5, at 1077 (noting that the origination and post-origination fees could "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 15, at 725.

<sup>19</sup> 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. <http://www.brokeroutpost.com/reference/27353.htm>; see also Bar-Gill, *supra* note 5, 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."))

<sup>20</sup> See Restatement (Second) of Contracts §1. See also *infra* Part II.A. It is entirely possible to argue that contracts are binding to give effect to at least a couple of competing norms, namely, autonomy or efficiency. See *supra* text accompanying notes 1-2. Which norm is given effect does not have a lot of bearing on my article, however, because regardless of the norm, the end result is the same—contracts are made binding. This simple but profound fact is justified because the contract law system adheres to a very specific set of assumptions. See *infra*

*Smoke, Mirrors & Contract Law*

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 over the objection of the other, now resisting party."<sup>22</sup>

Making contracts binding in this fashion, however, comes with unacknowledged costs. More precisely, the extent of state power that actually exists within the modern contract law system and its uses are concealed. As a specific consequence, unequal bargaining power becomes institutionalized within the system such that the party with superior bargaining power can, *if it so chooses*,<sup>23</sup> impose bad bargains<sup>24</sup> on its contracting partners with impunity.

The premise that contracts are made binding thus forms the basis of the two main arguments made in this Article, both of which focus on identifying and exposing the capacious amounts of state power hidden but nevertheless present in the modern contract law system. The first argument exposes the extent of state power in the modern contract law system, by examining the “why” underlying the premise—why are contracts made binding? The more specific question posed, however, is what justifies forcing a now resisting party to honor her contract?

Efficiency is simply not a sufficient reason to justify depriving someone of her liberty or property,<sup>25</sup> which is the result when a resisting party is forced to perform her contract (i.e., give

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text accompanying notes 61-68. Many, if not all of the assumptions would support either an autonomy or efficiency norm. So my focus is not on the norm but rather on the end result of the contract law system.

<sup>21</sup> See, generally Danielle Kie Hart, Contract Formation and the Entrenchment of Power, 41 Loy. Chi. L. J. 175, 204-16 (2009) (articulating in detail both aspects of “being bound” to a contract); see also *infra* Part II.A.

<sup>22</sup> 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 Wisc. L. Rev. 975, 987 (“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) (“in 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.”)

<sup>23</sup> 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. of Colorado 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.

<sup>24</sup> See *infra* text accompanying notes 316-26 (discussing bad bargains specifically).

<sup>25</sup> One can claim that all kinds of things, like racial discrimination, are efficient. See, e.g., Richard A. Epstein, *Forbidden Grounds: The Case Against Employment Discrimination Laws* (1992). That racial

## *Smoke, Mirrors & Contract Law*

up her liberty) or pay (i.e., give up her property in the form of her money) to get out of it. And autonomy certainly does not justify forcing a resisting party to do something she no longer wants to do, which is to perform her contract.<sup>26</sup> Instead, the modern contract law system uses several well-established assumptions about the contracting parties, including the way they behave when contracting, and the roles of the market and state,<sup>27</sup> to justify binding people to their contracts. For example, modern contract law assumes that contractual obligations are private transactions voluntarily undertaken by informed rational actors in a free market without interference by the state.<sup>28</sup> These assumptions provide the basic framework for the modern contract law system. If these assumptions are correct, then it is perfectly acceptable to make contracts binding and to hold parties, but particularly the resisting party, to them.<sup>29</sup>

The problem with making contracts binding, however, is that all of the assumptions are deeply problematic theoretically and in practice.<sup>30</sup> Because 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>31</sup> Such use

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discrimination may be efficient is not reason enough to adopt it as a policy. Efficiency generally seeks to promote welfare-maximization, which usually translates into wealth-maximization. See Michael B. Dorff & Kimberly Kessler Ferzan, *Miscalculating Welfare*, Southwestern Working Paper No. 0713 at 3, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1102819](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1102819) [hereinafter Dorff & Ferzan, *Welfare*]. Implicit in this focus on wealth maximization is the “assumption that social welfare rises monotonically with social wealth.” *Id.* It doesn’t. According to Dorff and Ferzan,

People often express a willingness to trade some material wealth in exchange for intangible values such as justice, fairness, or even predictability. Unjust seeming rules, then, are even more unlikely to maximize social welfare than they are to enhance social wealth. To truly enhance social welfare, economists should examine more closely the relationship between wealth, social values, and welfare.

*Id.* Consequently, to say that binding people to their contracts is efficient is insufficient to justify a principle that may very well be unjust or unfair in practice.

<sup>26</sup> See Singer, Hohfeld, *supra* note 22 at 987 (“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.”); 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, 1237 (1998) (the question of why “a person’s choice at one point in time determine[s] her legal obligations at another point in time[.]” is not answered by rational choice at all. “Instead, the very problem of contract enforcement is that one of the contractors does not want what the state is giving.”)

<sup>27</sup> See *infra* text accompanying notes 61-68.

<sup>28</sup> *Id.*

<sup>29</sup> 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.

<sup>30</sup> See *infra* Part III.A.

<sup>31</sup> 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 III.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

## *Smoke, Mirrors & Contract Law*

of state power smacks of absolutism, which stands in stark contrast to the characterization of contract law as promoting voluntary transactions between private parties.

The second argument exposes the fact that unequal bargaining power is not only directly derived from the state<sup>32</sup> but also a systemic and structural feature of the modern contract law system.<sup>33</sup> The latter part of the argument is established by exploring the more practical implications of the premise that contracts are made binding. All of the remedial mechanisms available to address unequal bargaining power are only available *after* a contract has already been formed.<sup>34</sup> In addition, the remedial mechanisms modern contract law relies upon to address inequality of bargaining power are either ineffective in most cases or simply do not work as presently constituted,<sup>35</sup> though they do provide good cover for the contract law system as a whole. The result is that the abuse or misuse of unequal bargaining power by the contracting party with more bargaining power often remains hidden and unchecked. In this fashion, unequal bargaining power is effectively institutionalized in the modern contract law system.

Thus, exploring the premise that contracts are made binding allows us to see the powerful role that the state plays in creating and maintaining a deeply flawed contract law system, one in which imbalances of power, not freedom and consent, are the hallmark. These imbalances are so deeply embedded that even mediocre remedial efforts, like disclosure statutes, reify rather than mitigate them. This result should be troubling for contract scholars and others who adhere to the notion that freedom and individuality are epitomized in the freedom of contract ideal.

With all of this in mind, the Article proceeds as follows: Part II. makes the argument that contracts are made binding focusing, in Part II.A., on the modern contract law system and, specifically, on its underlying assumptions, its core, which I argue is contract formation, its end result, i.e., binding contracts, and the way in which modern contract law ensures that it is a self-legitimizing system. Part II.B. then introduces disclosure statutes and situates them within the modern contract law framework by showing that disclosure statutes are a quintessential modern contract law remedial tool. This is because all of modern contract law's underlying assumptions are at work in a disclosure statute scenario.

Part III. exposes the extent of state power present in the modern contract law system by documenting, in Part III.A., the ways in which the assumptions that justify making contracts binding are genuinely flawed in theory and in practice. They are flawed in theory as the work of the Legal Realists, Critical Legal Studies scholars, relational contract theorists and, more

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contract law system relies on assumptions about the contracting parties to *justify* the use of state power to make contracts binding. See *infra* text accompanying notes 61-68 (discussing the assumptions). Absent the justification provided by the assumptions, therefore, making contracts binding becomes an *unmitigated* use of state power.

<sup>32</sup> See *infra* Part IV.A.

<sup>33</sup> See *infra* Part IV.B.

<sup>34</sup> But see the discussion of disclosure statutes, *infra*, Part II.B.

<sup>35</sup> See *infra* Part IV.B.

## *Smoke, Mirrors & Contract Law*

recently, behavioral law and economics scholars show. They are also flawed in practice as an examination of the subprime mortgage loan hypothetical will demonstrate.<sup>36</sup> In Part III.B., the universe of contracts to which that critique of the system applies is set out. In a nutshell, the critique applies to all contracts, for the simple reason that all of the modern contract law assumptions apply to every contract produced within the modern contract law system. Because all of the assumptions are contested and contestable, the inescapable conclusion to be drawn is that *all* contracts are made binding as an exercise of state power.

Part IV. then shows how unequal bargaining power is institutionalized within the modern contract law system and how power is once again concealed within the system to the detriment of parties with less bargaining power. Part IV.A. links Part III. and Part IV. by establishing the synergistic connection that exists between state power, which makes contracts binding, and individual bargaining power. Part IV.B. then makes the specific argument that the modern contract law system institutionalizes unequal bargaining power. Unequal bargaining exists, but it is not effectively reduced by the modern contract law system. Disclosure statutes, for example, do not mitigate the adverse consequences of unequal bargaining power in the form of information asymmetries. They do, however, make it harder to get out of a contract, which basically gives further effect to the premise that contracts are made binding. Consequently, reliance on disclosure statutes ends up creating a perverse result for modern contract law, to wit, exacerbating the bargaining imbalance usually present during contract formation in favor of the party with superior bargaining power. In the end, the use or abuse of unequal bargaining power remains hidden and unchecked and, in this way, becomes institutionalized.

Part IV.C. acknowledges that power is ubiquitous in law as it is elsewhere. But the systemic implications of continued adherence to the modern contract law assumptions coupled with the fact that contracts are made binding and the institutionalization of unequal bargaining power are profound. More specifically, all three things working together not only reify pre-existing distributions and power imbalances, they also aggravate them. As a practical consequence of all of this, modern contract law gives license to the party with more bargaining power to impose “bad bargains,”<sup>37</sup> if it so chooses, on its contracting partners with impunity.<sup>38</sup> The Article turns again to the subprime home mortgage example to illustrate these last points and, importantly, the justificatory and obfuscatory roles disclosure statutes and contract law play in this process.

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<sup>36</sup> See *supra* text accompanying notes 4-19.

<sup>37</sup> See *infra* text accompanying notes 316-26.

<sup>38</sup> A bad bargain does not have to be, nor is one necessarily imposed, every time one party has more bargaining power than its contracting partner. This may be because the bargaining power of the parties' are more evenly matched than in the CitiMortgage/Mary Smith hypothetical or because the party with more power chooses not to abuse its power. The point, however, is that because contracts are made binding, the party with superior bargaining can, *if it so chooses*, impose bad bargains on its contracting partners with impunity.

The Article concludes in Part V. with a contention. If a system that replicates, masks and exacerbates existing distributions and power differentials is acceptable, then nothing needs to be done and nothing further need be said. If, however, this result is objectionable on any level, then the fundamental, systemic and structural role power plays in the modern contract law system must at least be discussed. From there, the task is to figure out what if anything can or should be done about it.

## **II. Binding Contracts**

This part of the Article maps out how the modern contract law system makes contracts binding, Part II.A., and then situates disclosure statutes within the framework of modern contract law, Part II.B. Because an understanding of both is necessary to the development of the arguments and critique in Parts III. and IV., they are set out in some detail here.

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

Contract law allegedly shifted in the 1930s<sup>39</sup> from the classical to the modern system.<sup>40</sup> Modern contract law is different from classical contract in many ways. For example, modern contract law relies on standards rather than rigid, technical rules;<sup>41</sup> makes the context in which a contract was formed matter in a couple of important respects;<sup>42</sup> and gives expanded recognition to several “contract policing”<sup>43</sup> doctrines<sup>44</sup> and to reliance and restitution as alternatives to a traditional contract.<sup>45</sup>

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<sup>39</sup> This version of the evolution of contract law is not without its critics. See, e.g., Roy Kreitner, *CALCULATING PROMISES* 7 (2007) (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* (1974).

<sup>40</sup> The classical legal period lasted roughly seventy years, from 1860-1930s. See *AMERICAN LEGAL REALISM* xi (Fisher, Horwitz & Reed eds., 1993) [hereinafter *LEGAL REALISM*]; see Jay M. Feinman, *Un-Making Law: The Classical Revival in the Common Law*, 28 *Seattle U. L. Rev.* 1, 3 (2004) (noting that classical legal thought was dominant from 1870-1920); Singer, *Realism*, supra note 1, at 478 (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* 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–1990s. Feinman, *Un-Making*, at 11-14;

<sup>41</sup> E. Allan Farnsworth, *Some Prefatory Remarks: From Rules to Standards*, 67 *CORNELL L. REV.* 634 (1982); 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.* 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*].

<sup>42</sup> Knapp, *Offer*, supra note 41, at 317; Melvin Aron Eisenberg, *The Emergence of Dynamic Contract Law*, 88 *CAL. L. REV.* 1743, 1749, 1756-60 (2000) (providing interpretation for the agreed-to contract terms) [hereinafter *Eisenberg, Dynamic*]; Feinman, *Theory*, supra note 41, at 1287 (supplying additional terms); Speidel, *Domain* supra note 41, at 260–61 (supplying additional terms).

<sup>43</sup> “Contract policing” doctrines are doctrines used by courts to police contracts against, among other

## *Smoke, Mirrors & Contract Law*

Unlike classical contract, modern contract law also acknowledges that markets are not perfect<sup>46</sup> and, in fact, contain imperfections primarily in the form of information asymmetries and bargaining inequalities.<sup>47</sup> Modern contract law assumes, however, that such problems are correctable with discrete and relatively easy to implement solutions.<sup>48</sup>

Many of these changes implemented by modern contract law were an attempt to give effect to norms of fairness and cooperation as supplements to,<sup>49</sup> but not replacements of, the classical norms of individual autonomy and liberty.<sup>50</sup> All of these changes remain in place today, despite the alleged shift from modern contract to neo-classical contract law in the 1990s.<sup>51</sup> For

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things, unfairness and/or bargaining misbehavior in the formation process and inequality in the resulting exchange. See generally E. ALLAN FARNSWORTH, *CONTRACTS* §§ 4.1, 4.9 (4th ed. 2004) (discussing the policing of contractual agreements).

<sup>44</sup> Specifically, modern contract law gives expanded recognition to unconscionability, duress in the form of economic duress and misrepresentation. See, Hart, *supra* note 21, 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).

<sup>45</sup> Feinman, *Theory*, *supra* note 41, 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 41, 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 41, at 260–61. A traditional contract is one formed by mutual assent and consideration. See Restatement (Second) of Contract §17(1).

<sup>46</sup> Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 *HARV. L. REV.* 741, 750 (1982) (“[M]any contracts are made in markets that are highly imperfect.”) [hereinafter Eisenberg, *Bargain*].

<sup>47</sup> Morant, *MLK*, *supra* note 45, at 96 (“Anomalies of the marketplace included opportunism, the lack of perfect information, and bargaining inequity.”) (internal citations omitted); cf. Duncan Kennedy, *Distributive and Paternalistic 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 40, at 47 (discussing view that courts should assign right where they are most valuable, mimicking the real world imperfect market).

<sup>48</sup> See *infra* Part II.B. (discussing disclosure statutes).

<sup>49</sup> Melvin Aron Eisenberg, *The Responsive Model of Contract Law*, 36 *STAN. L. REV.* 1107, 1111-12 (1984) [hereinafter Eisenberg, *Responsive*]; Feinman, *Theory*, *supra* note 41, at 1288; Knapp, *Offer*, *supra* note 41, 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*].

<sup>50</sup> Peter Gabel & Jay Feinman, *Contract Law as Ideology*, in *THE POLITICS OF LAW* 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 45, at 97 (“While clinging to the notion of contractual freedom and bargaining autonomy, neoclassicists appreciated some of the realities of bargaining differences.”) (internal citations omitted).

<sup>51</sup> See Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 *FORDHAM L. REV.* 761, 773 (2002) [hereinafter Knapp, “Private”]; Ralph James Mooney, *The New Conceptualism in Contract Law*, 74 *OR. L. REV.* 1131, 1133–34 (1995). 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 40, at 16 (“Under the classical revival, formality

## *Smoke, Mirrors & Contract Law*

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

To begin with, the modern contract law system,<sup>52</sup> like the classical system, still presupposes that an individual acts rationally<sup>53</sup> in a largely unregulated market.<sup>54</sup> Moreover, individual liability is still premised on voluntary agreement.<sup>55</sup> Modern contract law also retains the public/private distinction<sup>56</sup> upon which much of classical legal thought was based.<sup>57</sup> As a result, the paradigm transaction under modern contract law, as under classical contract, is the private law transaction,<sup>58</sup> one that is framed by all of the following well-established<sup>59</sup> classical and now modern assumptions:<sup>60</sup>

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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 *supra* note 39 (acknowledging that this version of contract history is contested).

<sup>52</sup> Feinman, *Theory*, *supra* note 41, at \_\_\_ (text after n102)

<sup>53</sup> Jay M. Feinman, *Relational Contract Theory in Context*, 94 NW. U. L. REV. 737, 739, 743 (2000) [hereinafter Feinman, “Relational”]

<sup>54</sup> See Jay M. Feinman, *Book Review*, 55 J. LEGAL EDUC. 287, 293 (2005) [hereinafter Feinman, “Book Review”].

<sup>55</sup> Feinman, *Theory*, *supra* note 41, at \_\_\_ (text before n14)

<sup>56</sup> Classical legal thought was structured around several dichotomies, the most important of which was the public/private distinction. See Feinman, *Theory*, *supra* note 41, at 1286. Within the private law sphere of the public/private dichotomy, individual exercised rights and were free to agree on whatever contract terms they wanted. Singer, *Realism*, *supra* note 1, at 478, 479; P.S. Atiyah, *The Rise and Fall of Freedom of Contract* 403 (1979). The state ostensibly played no role in regulating the substantive terms of these private relations. LEGAL REALISM, *supra* note 29, at 99; Singer, *Realism*, *supra* note 1, 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 1, at 478, 480-81.

<sup>57</sup> Mensch, *History*, *supra* note 40, 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 . . .”) (emphasis in original).

<sup>58</sup> Jay M. Feinman, *Contract After the Fall*, 39 STAN. L. REV. 1537, 1538 (1987) (book review) [hereinafter Feinman, *Fall*]; Mensch, *History*, *supra* note 31 at 39, 41.

<sup>59</sup> See, e.g., Meredith R. Miller, *Contract Law, Party Sophistication and the New Formalism*, 75 Missouri 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.”) (quoting *Oppenheimer & Co., Inc. v. Oppenheim, Appel, Dixon & Co.*, 660 N.E.2d 415, 421 (N.Y. 1995)).

<sup>60</sup> 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 21, at 189, 195-98.

*Smoke, Mirrors & Contract Law*

- (1) A contract is a private transaction between private parties;<sup>61</sup>
- (2) Parties bargain at arm's length, meaning they are most likely strangers to one another;<sup>62</sup>
- (3) Individuals are rational actors in the marketplace;<sup>63</sup>
- (4) Contracts result from voluntary and informed choice;<sup>64</sup>
- (5) Contract law is the law of the market.<sup>65</sup> Markets are neutral and impartial, primarily self-regulating and largely outside of state control, but do

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<sup>61</sup> Atiyah, *supra* note 56 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.”); Hadfield, *supra* note 26, at 1261 (“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.”); Clare Dalton, *An Essay in the Deconstruction of Contract Doctrine*, 94 *Yale L. J.* 997, 1014 (1985) (“our 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 . . . [b]ut 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.”)

<sup>62</sup> See, e.g., Atiyah, *supra* note 56, 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 *Northwestern U. L. Rev.* 805, 808 (2000) (“classical contract law was implicitly based on a paradigm of bargains made between strangers transacting in a perfect market.”) [hereinafter Eisenberg, *Relational*].

<sup>63</sup> Eisenberg, *Relational*, *supra* note 62 at 808 (“classical 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) (individuals acted in their own self-interest) [hereinafter Feinman, *Critical*]; Atiyah, *supra* note 56, at 403.

<sup>64</sup> Hadfield, *supra* note 26, 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.”); Atiyah, *supra* note 56 at 403 (The fourth principle of classical contract law is that, “the deal is finally struck when the parties agree, or indicate their agreement . . . . The agreement must be ‘freely’ made 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 1, at 479 (arguing that the classical 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.)

<sup>65</sup> Atiyah, *supra* note 56 at 402 (noting that, “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 1 at 477-82; see generally Morton J. Horwitz, *The Historical Foundations of Modern Contract Law*, 87 *Harv. L. Rev.* 917, 936-52 (1974); Amy Dru Stanley, *From Bondage to Contract* (1998) (market theory of

*Smoke, Mirrors & Contract Law*

contain imperfections in the form of information asymmetries and bargaining inequalities.<sup>66</sup> Such imperfections, however, can be fixed with minimal interference from the state, thereby preserving the integrity of the market;<sup>67</sup> and

(6) The state's role is neutral and minimal.<sup>68</sup>

In addition, and significantly, modern and classical contract law are fundamentally the same because modern contract law left the core of classical contract, which is formation, completely intact.<sup>69</sup> Mutual assent and consideration remain the only two elements necessary to form a contract.<sup>70</sup> Indeed, modern contract law actually strengthens the core (formation), because it makes it easier to form a contract.<sup>71</sup> Specifically, modern contract law makes it particularly easy to establish mutual assent,<sup>72</sup> and the existence and adequacy of consideration is seldom, if ever, questioned in a market-based transaction.<sup>73</sup>

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contract is a post-emancipation phenomenon).

<sup>66</sup> Morant, MLK, supra note 45, at 95 (“Anomalies of the marketplace included opportunism, the lack of perfect information, and bargaining inequity.”) (footnotes omitted).

<sup>67</sup> 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 the ground rules of property and contract, providing legal institutions and mechanisms to facilitate market transactions, and maintaining social order.

Feinman, Book Review, supra note 54 at 293 (footnote omitted).

<sup>68</sup> The Critique of the Public/Private Distinction in American Legal Realism, William W. Fisher III et al editors 99 (1993); see also, Dalton, supra note 61 at 1012-13; Singer, Realism, supra note 1, at 479-80, 481.

<sup>69</sup> See generally, Hart, supra note 21 at Part III.B.

<sup>70</sup> 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 45, 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).

<sup>71</sup> See Hart, supra note 21, at Part III.B.3.

<sup>72</sup> Id. at 202-03, 204-10.

<sup>73</sup> See FARNSWORTH, supra note 6, § 2.2 at 48; Hart, supra note 21, 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).

## *Smoke, Mirrors & Contract Law*

Thus, modern contract law, like classical contract before it, creates a “presumption of contract validity”<sup>74</sup> upon formation of a traditional contract via mutual assent and consideration.<sup>75</sup> In other words, upon formation, the law will presume that a valid contract exists.<sup>76</sup> Significantly, the presumption of contract validity is very difficult to rebut under both the classical and modern systems, because: (1) the burden of proving that a contract is unenforceable<sup>77</sup> for any reason is on the party challenging or defending against the contract;<sup>78</sup> (2) *all* of the other contract doctrines that someone challenging or defending against the contract might use, including, but not limited to, contract interpretation,<sup>79</sup> the contract policing doctrines<sup>80</sup> and defenses to performance,<sup>81</sup> are literally outside the core—that is, to use them one must assume that an otherwise valid contract has been formed;<sup>82</sup> and (3) practical realities, like the expense of litigation,<sup>83</sup> the extensive use of certain boilerplate contract clauses,<sup>84</sup> and the fact that courts

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<sup>74</sup> See, generally, Hart, *supra* note 21, at Part III.B.4.

<sup>75</sup> A “traditional contract” is one formed via mutual assent and consideration. See Restatement (Second) of Contracts § 17(1) (1981).

<sup>76</sup> Hart, *supra* note 21, at 206.

<sup>77</sup> “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.

<sup>78</sup> Hart, *supra*, note 21, at 207, 212-15.

<sup>79</sup> 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. FARNSWORTH, *supra* note 6, § 7.7, at 440. 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 generally Hart, *supra* note 21, at 200-01 n. 147.

<sup>80</sup> 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 also Hart, *supra* note 21, at 201 n. 149.

<sup>81</sup> 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) (“[w]here 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)); accord RESTATEMENT (SECOND) OF CONTRACTS § 153 (1981) (unilateral mistake). See also Restatement (Second) of Contracts § 261 (impracticability of performance; the rule for impracticability states in pertinent part that, “[w]here, *after a contract is made*, a party's performance is made impracticable . . . his duty to render that performance is discharged . . .”); accord Restatement (Second) of Contracts § 265 (frustration of purpose—containing identical language). See also Hart, *supra* note 21, at 201 n. 150.

<sup>82</sup> Hart, *supra* note 21, Part III.B.2.

<sup>83</sup> 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 claim.”); 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*

*Smoke, Mirrors & Contract Law*

rarely let parties out of their contracts, regardless of the legal excuse advanced<sup>85</sup> make a successful rebuttal of the presumption of contract validity highly unlikely.<sup>86</sup>

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>87</sup> Enforceability, of course,

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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.”); Hart, *supra* note 21., at 212 n.209.

<sup>84</sup> 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 (2000) (arbitration clause); *Allied-Bruce Terminix Cos., Inc. v. Dobson*, 513 U.S. 265 (1995) (arbitration clause); *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991) (arbitration clause); *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213 (1985) (arbitration clause); *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585 (1991) (forum selection clause); *M/S Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972) (forum selection clause); *Johnson v. Ventra Group, Inc.*, 191 F.3d 732 (6th Cir. 1999) (choice of law clause); *Wang Labs., Inc. v. Kagan*, 990 F.2d 1126 (9th Cir. 1993) (choice of law clause); *Milanovich v. Costa Crociere, S.P.A.*, 954 F.2d 763 (D.C. Cir. 1992) (choice of law clause); *Interfirst Bank Clifton v. Fernandez*, 853 F.2d 292 (5th Cir. 1988) (choice of law clause). See also Hart, *supra* note 21, at 212-13 n. 212.

<sup>85</sup> 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); see also E. Allan Farnsworth, *Developments in Contract Law in 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.”); Charles L. Knapp, *Taking Contracts Private: The Quiet Revolution in Contract Law*, 71 FORDHAM L. REV. 761, 775 (2002) (noting that the burden of persuasion with respect to unconscionability claims “is at best difficult, [and] at worst literally impossible to satisfy”) [hereinafter Knapp, *Private*] (footnote omitted); Morant, *MLK*, *supra* note 45, at 110 (“The existence of . . . duress, 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); 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.”) (footnote omitted). See Hart, *supra* note 21, at 214 n.216.

<sup>86</sup> See generally, Hart, *supra* note 21, at 212-15.

<sup>87</sup> 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. In other words, that the terms are unreasonable may be okay as long as they are efficient and/or used fairly. 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 businesses will offer optimal terms under the assumption that the preferences of the marginal consumer are the same

represents the second component of a “binding contract,” because enforceability overtly implicates the state.<sup>88</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>89</sup> Thus, modern contract law, just like classical contract, makes contracts binding.

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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. of Emp. Legal Studies 447, 449 (2008) (discussing the argument of A Michael Spence, Monopoly, Quality, and Regulation, 6:2 Bell J. of Econ. 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 at 454 (discussing the argument of Alan Schwarz & Louis 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. C.f. Michael B. Dorff & Kimberly Kessler Ferzan, Is There a Method to the Madness? Why Creative and Counterintuitive Proposals Are Counterproductive, in \_\_\_\_\_ at 22 (2009). In addition, initial empirical research by Professor Florencia Marotta-Wurgler, makes me very skeptical of the claim. 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 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 (arguing that the “holder of an entitlement . . . may unilaterally waive or underenforce that entitlement[.]”); Gillette, supra note \_\_, at 708; see also Jolls, et al, supra note 87, at 1513-15 (re the fairness norm); Gillette, supra note \_\_ at 707 (re the reputational 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 Peter V. Letsou, The Political Economy of Consumer Credit Regulation, 44 Emory L.J. 587, 595 n. 21 (1995); Richard Craswell, Interpreting Deceptive Advertising, 65 B.U.L. Rev. 657, 723-724 (July 1985); Stephen Lubben, Railroad Receiverships and Modern Bankruptcy Theory, 89 Cornell L. Rev. 1420, fn. 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, i.e., legal counsel, will likely be different from the people who initially sold the product or service, i.e., 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. Otherwise the attorney(s) for the stronger party could face a malpractice claim, in the event the case lost in court. See also Hart, supra note 21, at 216.

<sup>88</sup> See Hart, supra note 21, at 212-15.

<sup>89</sup> The state puts its sovereign power in the service of one contracting party against the other by compelling the now resisting party (through its judges, sheriffs, and other state agents) to either pay or perform. Cohen, Contract, supra note 81, at 585–86; Singer, Realism, supra note 1, at 483–85.

*Smoke, Mirrors & Contract Law*

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>90</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 becomes embedded and largely immunized from effective challenge.<sup>91</sup>

Finally, and 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>92</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. From there, a remedy is adopted, which may or may not actually work, but is one that will nevertheless reaffirm and thereby re-legitimate the assumption(s) originally contradicted.<sup>93</sup>

For example, modern contract law assumes that unequal bargaining power exists,<sup>94</sup> but in an unproblematic way.<sup>95</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>96</sup> It also presents a problem when it takes the form of information asymmetry,<sup>97</sup> i.e., when one party is in possession

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<sup>90</sup> See, generally, Hart, *supra* note 21, at 216-17.

<sup>91</sup> *Id.*

<sup>92</sup> 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 a way that does not end up undermining the entire system. C.f. Feinman, *Critical*, *supra* note 63 (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 41 (documenting the ways in which modern contract law addressed various critiques leveled against the system); Gabel & Feinman, *supra* note 50 (exposing the legitimating 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 legitimates.

<sup>93</sup> Much of the discussion in the text is based on Duncan Kennedy's discussion of unequal bargaining power. See generally, Kennedy, *Distributive*, *supra* note 47, at 620-24.

<sup>94</sup> It is a form of market imperfection. See *supra* text accompanying notes 46-47 (modern system acknowledging market imperfections); see also Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, With Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 *Maryland L. Rev.* 563, 577 (1982); see also Morant, *MLK*, *supra* note 45, at 96.

<sup>95</sup> Barnhizer, *Inequality*, *supra* note 23, 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." In fact, Barnhizer notes that, "inequality of bargaining power alone is not a sufficient justification for judicial intervention into contract disputes." It is simply not explicitly discussed.)

<sup>96</sup> See *infra* text accompanying notes 316-26; see also Hart, *supra* note 21.

<sup>97</sup> See Daniel D. Barnhizer, "Bargaining Power in Contract Theory," in *Visions of Contract Theory*, at 93-94 (2007) ("Legal and nonlegal observers recognize qualities such as superior information . . . as sources of

of relevant information that is deemed necessary for the other party to making an informed decision about whether to enter into a contract.<sup>98</sup>

To correct these problems, modern contract law relies upon its contract policing doctrines and disclosure statutes, respectively.<sup>99</sup> Unfortunately, these solutions do not work very well.<sup>100</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>101</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>102</sup> not the norm.<sup>103</sup> And because it can essentially treat unequal bargaining power as the exception, modern contract law is able to reaffirm and re-legitimate its assumption that unequal bargaining power exists but only at the margins, as an exception that proves the rule and supports the general paradigm of equality.<sup>104</sup>

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power.”) [hereinafter, Barnhizer, “Bargaining Power”]; Omri Ben-Shahar & Carl E. Schneider, *The Failure of Mandated Disclosure*, U of Chicago Law & Economics, Olin Working Paper No. 516 at 3 (the purpose of mandatory disclosure is to “keep the discloser from abusing its superior position.”) See also *supra* text accompanying notes 97-98.

<sup>98</sup> C.f. Barnhizer, *Inequality*, *supra* note 23 at 147 (“fraud, 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.”) (internal citation omitted).

<sup>99</sup> See Hart, *supra* note 21 (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); see *infra* Part \_\_\_ (discussing purpose of disclosure statutes).

<sup>100</sup> See Hart, *supra* note 21 (explaining in detail why contract policing doctrines do not adequately address the unequal bargaining power that produces a bad bargain problem); see *infra* Part IV.B. (explaining why disclosure statutes do not work).

<sup>101</sup> Kennedy, *Distributive*, *supra* note 47, at 620.

<sup>102</sup> Robert W. Gordon, *Macaulay, Macneil, and the Discovery of Solidarity and Power in Contract Law*, 1985 *Wis. L. Rev.* 565, 571 (“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.”)

<sup>103</sup> Kennedy, *Distributive*, *supra* note 47, 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.”)

<sup>104</sup> 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.

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>105</sup> and a lot has been written about them.<sup>106</sup> At their most basic, disclosure statutes are statutes that require certain pieces of information to be disclosed by one party to the other. They exist to a large extent in the consumer protection arena (i.e., the Truth in Lending Act<sup>107</sup> and the Magnuson-Moss Warranty Act), but are not limited to this area.<sup>108</sup> For example, several provisions of Article 2 of the

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<sup>105</sup> See, e.g., William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 *Wisconsin L. Rev.* 400 (“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.”) (hereinafter, Whitford, *Disclosure*) [footnotes omitted]; 15 U.S.C. §§1601-1615, 1631-49, 1661, 1667(f) (2000 & Supp. II 2004) (implemented by the Federal Reserve Board via Regulation Z, 12 C.F.R. §226 (2005)); Magnuson-Moss Warranty Federal Trade Commission Improvement Act, Pub. L. No. 93-637, ss 101-112, 88 Stat. 2183 (1975) (codified at 15 U.S.C. ss 2301-12 (2000)).

<sup>106</sup> See, e.g., Jo Carrillo, *Dangerous Loans: Consumer Challenges to Adjustable Rate Mortgages*, 5 *BERKELEY BUS. L.J.* 1, 31, 33-43 (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 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, (2008); Matthew A. Edwards, *The Law, Marketing and Behavioral Economics of Consumer Rebates*, 12 *STAN. J.L. BUS. & FIN.* 362, 407-13 (2007); 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 15; 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 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, (1997); Whitford, *Disclosure*, *supra* note 105.

<sup>107</sup> Truth in Lending Act, 15 U.S.C. §§1601-1615, 1631-49, 1661, 1667(f) (2000 & Supp. II 2004) (implemented by the Federal Reserve Board via Regulation Z, 12 C.F.R. §226 (2005)).

<sup>108</sup> 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 97, at 11, 12 (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 and constitutional rights, for example. *Id.* at 3, 3-15.

*Smoke, Mirrors & Contract Law*

Uniform Commercial Code also require disclosure, namely, the provisions on good faith,<sup>109</sup> unconscionability<sup>110</sup> and warranty,<sup>111</sup> and they apply to merchants as well as consumers.<sup>112</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>113</sup> allow the market to work,<sup>114</sup> and allow for the possibility of individual choice.<sup>115</sup> By putting all of this together, it appears that the main reason for adopting a disclosure regime is to

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<sup>109</sup> See, e.g., 1-201(19), 1-203, 2-103(b) [of the current version of Article 2]. 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 *Virginia 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’ 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.”) (footnote omitted).

<sup>110</sup> See UCC §2-302; see also, Whitford, *Disclosure*, *supra* note 105 at 401 (“The Uniform Commercial Code, in what few efforts it makes to regulate consumer transactions, generally stresses disclosure regulation[,]” citing unconscionability as the example.) (footnote omitted); see generally, Arthur Allen Leff, *Unconscionability and the Code—The Emperor’s New Clause*, 115 *U. Pa. L. Rev.* 485 (1967).

<sup>111</sup> See UCC §§2-313 (express warranties), 2-314 (the implied warranty of merchantability) and 2-316 (disclaimer of warranties). See also Summers, *supra* note 109 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.)

<sup>112</sup> Nothing in the text or comments of any of the cited Article 2 provisions limits their application to consumers transactions exclusively.

<sup>113</sup> *C.f.* Calamari & Perillo, *Contracts* s 10-1 at 430 (3d ed. 1987).

<sup>114</sup> Scott J. Burnham, *The Regulation of Rent-To-Own Transactions*, 3 *Loy. Consumer L. Rep.* 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 *Stanford L. Rev.* 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.”); Florencia Marotta-Wurgler, *Does Disclosure Matter?* at 1 (paper on file with author) [hereinafter Marotta-Wurgler, “Disclosure”].

<sup>115</sup> *C.f.* 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.”); 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); *C.f.* Louis Kaplow & Steven Shavell, *Microeconomics* 40 (Foundation Press 2004) (“when 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 when a party, as opposed to the government and pursuant to a disclosure requirement, provides the information to the consumer.)

correct bargaining imbalances and market failure, primarily in the form of information asymmetries, thereby improving the quality of the contractual decisions made.<sup>116</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>117</sup> They preserve individual autonomy, the core value of the classical legal system,<sup>118</sup> while simultaneously deploying the modern norms of fairness and cooperation.<sup>119</sup> More specifically, disclosure statutes protect the parties' freedom of contract—the classical autonomy value<sup>120</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>121</sup>

Second, disclosure statutes are designed to affect the core of contract (formation)<sup>122</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>123</sup> thereby increasing the quality of the “weaker contracting party's”<sup>124</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>125</sup> if that party appears to have made an informed decision to

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<sup>116</sup> Larry T. Garvin, *Small Business and the False Dichotomies of Contract Law*, 40 *Wake Forest L. Rev.* 295(at 18-19) (2005) (“many regulations require that sellers disclose information . . . . All of these seek to lower the costs of acquiring or processing the most important information, thus raising the quality of the decisions made.”); John Roddy, *Reversing Field: Is There a Trend Toward Abrogating Truth in Lending?*, 772 *PLI/Comm* 637, 642 (1998) (“The purpose of TILA is to enable consumers to intelligently shop for credit.”); Whitford, *Disclosure*, *supra* note 105 at 403 (noting that “proponents 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.”); C.f. 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).

<sup>117</sup> 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 49-50.

<sup>118</sup> See *supra* text accompanying note 50.

<sup>119</sup> See *supra* text accompanying note 49.

<sup>120</sup> Ben-Shahar & Schneider, *supra* note 97, at 24 (“mandated 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.”)

<sup>121</sup> 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.

<sup>122</sup> See *supra* text accompanying notes 69-73 (discussing formation as core of contract law).

<sup>123</sup> See *supra* text accompanying notes 113-16 (discussing the primary purpose of disclosure statutes).

<sup>124</sup> 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.

<sup>125</sup> See *supra* text accompanying notes 74-91 (discussing the presumption of contract validity).

*Smoke, Mirrors & Contract Law*

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>126</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>127</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>128</sup> Thus, for example, under TILA, creditors are required to disclose in writing to the borrower, among many other things,<sup>129</sup> the finance charge<sup>130</sup> and the annual percentage rate.<sup>131</sup> 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>132</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>133</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

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<sup>126</sup> See supra text accompanying notes 69-73 (discussing modern contract's approach to formation).

<sup>127</sup> See, supra notes 61-68.

<sup>128</sup> C.f. Willis, supra note 15, 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.")

<sup>129</sup> For example, the creditor is required to disclose the "total sale price," the "total of payments," and any dollar charge or percentage amounting which may be imposed solely because of a late payment. See 15 U.S.C. §1638(a)(7) (total sale price); 15 U.S.C. §1638(a)(5) (total of payments); 15 U.S.C. §1638(a)(10).

<sup>130</sup> 15 U.S.C.A. §1638(a)(3).

<sup>131</sup> 15 U.S.C. §1664; 12 C.F.R. §226.24. See also Willis, supra note 15, 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 . . .")

<sup>132</sup> Louis Kaplow & Steven Shavell, *Microeconomics* at 38 (Foundation Press 2004) ("By providing consumers with information, government enables them to base their purchase decisions on correct information and thereby to avoid mistakes."); Willis, supra note 15 at 16.

<sup>133</sup> C.f., Morant, Race, supra note 49, at (Westlaw doc pg 5-6) (1997) ("Emphasis is placed upon the enforcement of agreements if objective assent is manifested.") (footnote omitted); C.f. . Omri Ben-Shahar, The Myth of the "Opportunity to Read" in Contract Law, John M. Olin Law & Economics Working Paper No. 415 (2d Series) at 3 (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.") [hereinafter, Ben-Shahar, "Opportunity."]

decisions, meaning that the individual who received 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>134</sup> and the law should give their bargain literal effect, that is, protect the parties' "justified" expectations based on their contract, because it is the product of their voluntary and informed choice.<sup>135</sup> This latter statement is, of course, freedom of contract's well-known corollary that contracts should be kept.<sup>136</sup> The state's role in all of this is very neutral and minimal, having only specified that disclosures are required in certain limited commercial contracting situations, and the content of the disclosures to be made.<sup>137</sup>

The fundamental problem for both the modern contract law system and disclosure statutes, however, is that all of modern contract law's assumptions<sup>138</sup> are deeply problematic in theory and in practice.<sup>139</sup> It is to this discussion that the Article now turns.

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<sup>134</sup> Freedom of contract is also the embodiment of the classical individual autonomy norm writ large.

<sup>135</sup> Atiyah, *supra* note 56 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 49 at ? ("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.") (footnote omitted).

<sup>136</sup> 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 II.A. (discussing the ways in which modern contract law makes contracts binding); see, also, Singer, Realism, *supra* note 1, at 478-79 (arguing that the classical theorists assumed, in their basic model, "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."); Todd D. Rakoff, Is "Freedom From Contract" Necessarily A Libertarian Freedom?, 2004 *Wisc. L. Rev.* 477, 479-80 (Rakoff, in analyzing Sir George Jessel's famous statement about freedom of contract, argues 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.'") 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."); Friedrich Kessler, Contracts of Adhesion—Some Thoughts About Freedom of Contract, 43 *Columbia L. Rev.* 629, 629-30 (1943).

<sup>137</sup> See *supra* text accompanying notes \_\_\_-\_\_\_.

<sup>138</sup> See *supra* text accompanying notes 61-68.

<sup>139</sup> Ben-Shahar, Myth, *supra* note 133, at 3 ("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

### **III. Contracts and State Power**

The discussion in Part II went to some lengths to establish the framework of the modern contract law system and to situate disclosure statutes within it. This Part of the Article, however, is devoted to dismantling all of the assumptions underlying modern contract law and, consequently, disclosure statutes (Part III.A.) for the specific purpose of exposing the extent of state power in the modern contract law system. The argument and conclusion of this section is that *all* contracts are made binding as an exercise of state power, which is the discussion in Part III.B.

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

There are six,<sup>140</sup> well-established assumptions that modern contract law uses to justify making contracts binding and which explain modern contract's use of disclosure statutes as a remedial tool.<sup>141</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 society.<sup>142</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>143</sup> It was also understood that “mere freedom as absence of restraint,

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designed by the parties . . . It is a heroic scholarly ideal, however, to preserve this module in the era of mass standard form contracts.”)

<sup>140</sup> Some of the assumptions are so related to one another that the only way to logically discuss them is together. For example, the modern contract law assumption about the role of the state subsumes the claim that: (1) the state's role is neutral and minimal, *and* (2) contracts are between two private parties. See *infra* Part III.A.4.

<sup>141</sup> See *supra* text accompanying notes 61-68 (the assumptions); 127-37 (relationship to disclosure statutes).

<sup>142</sup> Singer, *Realism*, *supra* note 1, at 482; Cohen, *Contract*, *supra* note 22, at 559 (1933); see generally Robert L. Hale, *Law Making By Unofficial Minorities*, 20 *Colum. L. Rev.* 451 (1920) [hereinafter Hale, “Minorities”]; Morris R. Cohen, *Property and Sovereignty*, 13 *Cornell L. Q.* 8 (1928) [hereinafter Cohen, “Property”]; Robert L. Hale, *Bargaining, Duress, and Economic Liberty*, 43 *Colum. L. Rev.* 603 (1943) [hereinafter Hale, “Duress”]. This insight is also well-established in historical discourse. See, e.g., William J. Novak *The People's Welfare* (1996); Richard R. John, *Spreading the News* (1995); Christopher L. Tomlins, *Law, Labor, and Ideology in the Early American Republic* (1993); William E. Forbath, *Law and the Shaping of the American Labor Movement* (1989); Hendrik Hartog, *Public Property and Private Power* (1983)

<sup>143</sup> Cohen, *Contract*, *supra* note 22, 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*] (arguing that 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.”)

*Smoke, Mirrors & Contract Law*

without positive power to achieve what we deem good, is empty and of no real value.”<sup>144</sup> The state therefore created legal rules, both formal, i.e., through legislation, agency rules and court decisions,<sup>145</sup> and “informal” via private agreement.

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 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>

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<sup>144</sup> Cohen, *Contract*, supra note 22, at 560; see also *id.* at 561-62 (discussing the fact that “the theory of non-interference of the government in business, is not really held consistently by those who so frequently invoke it.”)

<sup>145</sup> Cohen, *Contract*, supra note 22, at 586.

<sup>146</sup> Cohen, *Property*, supra note 142, at 11-14; Robert L. Hale, *Coercion and Distribution in a Supposedly Non-Coercive State*, 38 *Political Science Quarterly* 470, 471-74 (1923) [hereinafter Hale, “Coercion”]; Singer, *Realism*, supra note 1, at 487-88; Mensch, *History* at 34-35.

<sup>147</sup> Cohen, *Contract*, supra note 22, at 570.

<sup>148</sup> 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 note 142 at 627-28 (noting first that not all state bestowed property rights are equal—some are endowed with more advantageous rights than others. Hale then argues that, “[i]t is with these unequal rights that men bargain and exert pressure on one another. These rights give birth to the unequal fruits of bargaining.”).

<sup>149</sup> 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 142, at 13.

<sup>150</sup> Cohen, *Contract*, supra note 22, at 587, 585-86.

<sup>151</sup> 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 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.

Cohen, *Contract*, supra note 22, at 587.

<sup>152</sup> Cohen, *Contract*, supra note 22, at 591, 555-57, 587.

<sup>153</sup> Cohen, *Contract*, supra note 22, at 558.

### *Smoke, Mirrors & Contract Law*

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-regulating, free market is built, operated and continues to operate.<sup>156</sup> Indeed, absent the legal structure provided by state imposed regulation (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. By refraining from acting in a formal manner, the state essentially leaves informal rules and rule-making<sup>158</sup> in place. 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>159</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>160</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 “[p]lace of commercial activity in which articles are bought and sold.”<sup>161</sup> In marketing, however, a “market” requires three things. 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>162</sup>

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<sup>154</sup> Singer, Standards, supra note 143, at 4.

<sup>155</sup> American Legal Realism, supra note 40, at 99-100; Singer, Standards, supra note 143, at 10-11.

<sup>156</sup> Singer, Standards, supra note 143, at 11.

<sup>157</sup> Singer, Standards, supra note 143, at 4.

<sup>158</sup> See supra text accompanying notes 142-53.

<sup>159</sup> Singer, Realism, supra note 1, 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 §§ 273-74 (2006); Uniform Anatomical Gift Act of 1987 § 10(a).

<sup>160</sup> Singer, Realism, supra note 1, at 482; see also Cohen, Property, supra note 142, at 11-13.

<sup>161</sup> Black’s Law Dictionary 500 (Abridged 5<sup>th</sup> ed. 1983).

<sup>162</sup> <http://www.netmba.com/marketing/market/definition/>

*Smoke, Mirrors & Contract Law*

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 only obtained the home mortgage loan 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>163</sup> including, but not limited to: New Deal housing programs, like the Home Owners Loan Corporation,<sup>164</sup> and agencies, particularly the Federal Housing Administration and Veterans Administration;<sup>165</sup> federal and state highway programs;<sup>166</sup> state urban renewal programs;<sup>167</sup> and, perhaps surprisingly, United States Supreme Court cases like *Brown v. Board of Education*,<sup>168</sup> *Miliken v. Bradley*<sup>169</sup> and *San Antonio Independent School*

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<sup>163</sup> 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 *Howard L. Rev.* 547 (1979); Douglas S. Massey & Nancy A. Denton, *American Apartheid: Segregation and the Making of the Underclass* (1993); see also Reggie Oh, *Apartheid in America: Residential Segregation and the Colorline in the Twenty-First Century*, 15 *B.C. Third World L.J.* 385, 388-98 (1995); 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].

<sup>164</sup> The Home Owners Loan Corporation (“HOLC”) was a federal entity created in 1933 by the Roosevelt Administration. Oh, *supra* note 163 at 390. Its primary purpose was to increase home ownership among American families. *Id.* (footnote omitted). 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 (footnotes omitted). As a result, the practices of the Home Owners Loan Corporation only ended up increasing home ownership for white families in white neighborhoods. *Id.* at 390-91.

<sup>165</sup> 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 163 at 1063 (footnotes omitted); see also Oh, *supra* note 163 at 391-92.

<sup>166</sup> Kushner, Second, *supra* note 163 at 1064 (“The federal highway program also helped fund the segregated suburban exodus. In addition, state and local highway and urban renewal programs produced massive relocation which resettled white displacees in suburbia and blacks in the increasingly concentrated minority sections of central cities.”)

<sup>167</sup> *Id.*

<sup>168</sup> 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 163 at 1065.

<sup>169</sup> 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, [*Miliken*] insulated the white suburbs from busing and further encouraged the establishment of separate societies.” Kushner, Second, *supra* note 163 at 1065.

*Smoke, Mirrors & Contract Law*

*District v. Rodriguez*.<sup>170</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>171</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.

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>172</sup> (established the Office of Comptroller of the Currency [OCC])<sup>173</sup>
- **1913: The Federal Reserve Act**<sup>174</sup> (established the Federal Reserve System [FRS])
- **1933: The Banking Act, a.k.a., the Glass-Steagall Act**<sup>175</sup> (established the Federal Deposit Insurance Corporation [FDIC], supervised state banks not otherwise under

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<sup>170</sup> 411 U.S. 1 (1983). Kushner, Second, *supra* note 163 at 1065 n. 61 (In refusing to equalize district school funding in *San Antonio Independent School District v. 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).

<sup>171</sup> Kushner, Second, *supra* note 163 at 1064 (citation omitted).

<sup>172</sup> National Bank Act, ch. 106, §5, 13 Stat. 100 (1864) (current version as amended in at 12 U.S.C.A. §21 et seq (2006)).

<sup>173</sup> GAO—09-216 Financial Regulation Report, *supra* note \_\_, at 6 (Figure 1); National Bank Act, ch 106, §5, 13 Stat. 99 (current version as amended in 12 U.S.C.A §21 (2006))

<sup>174</sup> Federal Reserve Act, ch. 6, § 1, 38 Stat. 251 (1913) (current version as amended in scattered sections of 12 U.S.C.A (2006)).

<sup>175</sup> The Banking Act of 1933, ch. 89, 48 Stat. 162 (codified as amended at 12 U.S.C. §§1811-1832 (2006)).

*Smoke, Mirrors & Contract Law*

federal regulation, extended federal supervision to all commercial banks, and separated commercial from investment banking)<sup>176</sup>

- **1933: The Securities Act**<sup>177</sup> (established a federal disclosure regime for companies seeking to issue stocks for sale to the general public)<sup>178</sup>
- **1934: The Securities Exchange Act**<sup>179</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>180</sup>
- **1934: The National Housing Act**<sup>181</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>182</sup>
- **1989: The Financial Institutions Reform, Recovery, and Enforcement Act**<sup>183</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>184</sup>

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<sup>176</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 6 (Figure 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. Law 301, 317 n.77 (2009).

<sup>177</sup> The Securities Act of 1933, ch. 38, 48 Stat. 74 (codified as amended at 15 U.S.C. §§77a-77aa (2006))

<sup>178</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 6 (Figure 1); Silvers & Slavkin, supra note 176, at 317 n.77.

<sup>179</sup> Securities Exchange Act, 15 USCA 78 (a-oo) (2006).

<sup>180</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 6 (Figure 1); Silvers & Slavkin, supra note 176, at 317 n.77.

<sup>181</sup> National Housing Act, ch. 847, 48 Stat. 1246 (1934) (current version scattered in sections of 12 U.S.C.A (2006)).

<sup>182</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 6 (Figure 1); Silvers & Slavkin, supra note 176, at 316 n.76; id. at 319.

<sup>183</sup> 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.)

<sup>184</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 7 (Figure 1); Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, pmb., 103 Stat. 183, 183; Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, §101, 103 Stat. 183, 187; Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, §401(a)(1), §401(e)(1), 103 Stat. 183, 354, 356; Financial Institutions Reform, Recovery, and Enforcement Act of 1989, Pub. L. No. 101-73, §702(a)(2A)(a)(1), 103 Stat. 183, 413

*Smoke, Mirrors & Contract Law*

- **2000: The Commodity Futures Modernization Act**<sup>185</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>186</sup>
- **2002: The Sarbanes-Oxley Act**<sup>187</sup> (improved accuracy and reliability of corporate disclosures made pursuant to securities laws; established the Public Company Accounting Oversight Board [PCAOB])<sup>188</sup>

The regulatory history, of course, does not take into account either the history of deregulation of the financial market or the extent of 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>189</sup> was enacted, which pre-empted state imposed interest rate caps.<sup>190</sup> Then, in 1982, Congress passed the Garn-St. Germain Act,<sup>191</sup> which allowed thrifts to expand beyond mortgage lending into commercial lending, credit cards, and real estate investing,<sup>192</sup> and the Alternative Mortgage Transactions Parity Act,<sup>193</sup> which relaxed restrictions on lenders' ability to offer adjustable rate mortgages.<sup>194</sup> In 1996, the National Securities Markets Improvement Act<sup>195</sup> pre-empted most state oversight of nationally traded securities.<sup>196</sup> Finally, in 1999, Congress passed the Gramm-Leach-Bliley Act,<sup>197</sup> which repealed the Glass-Steagall Act and eliminated restrictions on banks, securities firms, and insurance companies from affiliating with each other.<sup>198</sup> Ironically, the Gramm-Leach-Bliley Act is the

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<sup>185</sup> Commodity Futures Modernization Act of 2000, Pub. L. No. 106-554, 114 Stat. 2763 (codified as amended in scattered sections of 7, 11, 12 & 15 U.S.C.).

<sup>186</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 7 (Figure 1); Commodity Futures Modernization Act of 2000 § 108, 7 U.S.C. § 5 (2006).

<sup>187</sup> 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.).

<sup>188</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 7 (Figure 1); Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, pmb., 116 Stat. 745, 745; Sarbanes-Oxley Act of 2002 §101, 15 U.S.C. § 7211 (2006).

<sup>189</sup> The Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132 (codified as amended in non-sequential parts of 12 U.S.C.).

<sup>190</sup> Silvers & Slavkin, supra note 176, at 320.

<sup>191</sup> Pub. L. No. 97-320, 96 Stat. 1469 (codified as amended in non-sequential sections of 12 U.S.C.).

<sup>192</sup> Silvers & Slavkin, supra note 176, at 320.

<sup>193</sup> 12 U.S.C. §§3801-3806 (2000).

<sup>194</sup> Silvers & Slavkin, supra note 176, at 321.

<sup>195</sup> 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.).

<sup>196</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 7 (Figure 1); National Securities Markets Improvement Act of 1996, Pub. L. No. 104-290, pmb., 110 Stat. 3416, 3416; National Securities Markets Improvement Act of 1996 § 102, 15 U.S.C. § 7r(a)-(b) (2006).

<sup>197</sup> 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.).

<sup>198</sup> GAO—09-216 Financial Regulation Report, supra note \_\_, at 7 (Figure 1); Gramm-Leach-Bliley Act,

piece of federal legislation that enabled Citicorp to merge with Travelers Group in 1998 to form Citigroup. In other words, Citigroup, the parent company of CitiMortgage, only exists 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 federal side by the Office of the Comptroller of the Currency<sup>199</sup> and, in California, the Department of Financial Institutions.<sup>200</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 demonstrates, 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>201</sup> This notion of voluntariness is what ostensibly separates contracts from other areas of “public” law, like torts.<sup>202</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>203</sup> To the Realists,

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Pub. L. No. 106-102, pmb., 113 Stat. 1338, 1338 (1999).

<sup>199</sup> The Office of the Comptroller of the Currency “charters, regulates, and supervises all national banks.” See [www.occ.treas.gov](http://www.occ.treas.gov).

<sup>200</sup> According to its website, the California Department of Financial Institutions is the state regulator responsible for overseeing “California’s state-chartered financial institutions.” See <http://www.dfi.ca.gov>. 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.*

<sup>201</sup> See *supra* text accompanying note 62 (discussing the modern contract law assumption that contracts are voluntary).

<sup>202</sup> See, *supra*, note 56 (discussing public part of the public/private distinction).

<sup>203</sup> See, generally, Hale, Coercion, *supra* note 146; Hale, Duress, *supra* note 142. There is, of course, more recent scholarship on coercion. See, e.g., Pierre Bourdieu, *The Social Structures of the Economy* (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*

coercion was ubiquitous and “at the heart of every bargain.”<sup>204</sup> This was because *mutual coercion* exists in every contract<sup>205</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>206</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>207</sup> Not surprisingly, the more one party owns (in terms of quantity and/or value), the more potent that party’s threat to withhold becomes.<sup>208</sup> Accordingly, coercion exists *whenever* a party assents to a contract to avoid the consequences with which the other threatens him.<sup>209</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>210</sup>

Thus, in the context of the home mortgage loan between CitiMortgage and Mary Smith, Mary Smith surrendered a portion of her property (i.e., a property right in the house she purchased via the mortgage and in her money, by agreeing 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.

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*Dream.*

<sup>204</sup> Elizabeth Mensch, Freedom of Contract as Ideology, 33 STAN. L. REV. 753, 764 (1981) [hereinafter Mensch, Ideology].

<sup>205</sup> Mutual coercion literally encompasses the idea that each party to a contract coerces the other. See, e.g., Hale, Coercion, supra note 146, at 474 (discussing how customers and workers can weaken the owner’s coercive power by, in the case of customers, “through their law-given power to withhold access to their cash, the laborers through their *actual* power to . . . to withhold their services.”) (emphasis in original); Patterson, supra note 212, at 741-42 (discussing refusal to give consideration unless the promisor makes a return promise); see also Hale, Duress, supra note 142, at 604, 606, and 626 (discussing other examples of mutual coercion). For more recent work acknowledging that mutual coercion exists in every contract, see Barnhizer, Inequality, supra note 23, at 163-65.

<sup>206</sup> See, generally Hale, Coercion, supra note 146; Cohen, Property, supra note 142; Singer, Realism, supra note 1, at 486; Mensch, Ideology supra note 204, at 764.

<sup>207</sup> Cohen, Property, supra note 142, at 11-14; Hale, Coercion, supra note 146, at 471-74; Singer, Realism, supra note 1, at 487-88; Mensch, History, supra note 40, at 34-35.

<sup>208</sup> Hale, Coercion, supra note 146, at 471-73; Hale, Duress, supra note 142, at 627; Cohen, Property, supra note 142, at 11-13; Singer, Realism, supra note 1, at 486; Mensch, Ideology supra note 204, at 764. 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 146-49 (discussing bargaining power and how much one is allowed to acquire).

<sup>209</sup> See, e.g., Hale, Duress, supra note 142, at 604, 606.

<sup>210</sup> Hale, Duress, supra note 142, at 606; see also, Cohen, Property, supra note 142, at 12 (“If . . . somebody . . . 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.”)

*Smoke, Mirrors & Contract Law*

The sine qua non of coercion is simply that a threat induces the parties to enter the contract.<sup>211</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>212</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 choose between the lesser of two evils.<sup>213</sup> A person will therefore choose to enter into a particular transaction to avoid the threat of something worse.<sup>214</sup>

Perhaps more importantly, the fact that someone exercised a choice does not indicate a lack of compulsion.<sup>215</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>216</sup> Society is premised on property rights,<sup>217</sup> which are bestowed by the state.<sup>218</sup> Property rights are not bestowed equally.<sup>219</sup> One cannot use an owner's property without the owner's consent,<sup>220</sup>

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<sup>211</sup> See, e.g., Hale, Duress, supra note 142, at 604, 606.

<sup>212</sup> See Dawson, supra note 104, 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.") (emphasis in original); Patterson, supra note 212, at 741-42 (specifically asking whether "compulsion negate[s] 'freedom of consent' and thus negate[s] consent?" and answering the question in the negative. He states that, "[e]ven non-permissible pressure does not negate consent."); see also Hale, Duress, supra note 142 at 606.

<sup>213</sup> Hale, Duress, supra note 142, at 618 (discussing Justice Holmes' opinion in the *Union Pacific Ry. Co. v. Public Service Commission*, 248 U.S. 67, 70 (1918)).

<sup>214</sup> Hale, Duress, supra note 142, at 605-06.

<sup>215</sup> Hale, Duress, supra note 142, at .

<sup>216</sup> Hale, Duress, supra note 142, at 606; Hale, Coercion, supra note 146, at 470.

<sup>217</sup> See generally Cohen, Property, supra note 142, at 11-14.

<sup>218</sup> Id.

<sup>219</sup> See supra text accompanying notes 147-50, 207-08. 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. Id.

because the state will enforce the owner's right to keep other people's hands off of his things.<sup>221</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>222</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. And an owner will not give his consent, unless he is paid.<sup>223</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 between the lesser of two evils.<sup>224</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>225</sup> or to 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>226</sup> Thus, if Mary Smith had chosen to rent rather than be homeless, her decision

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<sup>220</sup> Hale, Coercion, supra note 146, 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."); Cohen, Property, supra note 142, 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.")

<sup>221</sup> See Hale, Duress, supra note 142, 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 142, at 11-14.

<sup>222</sup> 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 and service from those who wish to [make use of] it." Cohen, Property, supra note 142, at 12.

<sup>223</sup> Hale, Duress, supra note 142, 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 142, at 113.

<sup>224</sup> Hale, Duress, supra note 142, at 618 (discussing Justice Holmes' opinion in the *Union Pacific Ry. Co. v. Public Service Commission*, 248 U.S. 67, 70 (1918)).

<sup>225</sup> 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 following notes 203-10 (discussing the mutual coercion in the CitiMortgage/Mary Smith loan).

<sup>226</sup> Hale, Coercion, supra note 146, at 472 ("the 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[.]")

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. Because Ms. Smith was confronted with the same threat, the question is which option (renting or buying) is the lesser evil? Given that homeownership is set up to be the more attractive option,<sup>227</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>228</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>229</sup> It is to say, 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>230</sup> But here again, modern contract law is mistaken. Contracts are public, for two related reasons.

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<sup>227</sup> 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/or other things. Homeowners also enjoy tax incentives not available to renters.

<sup>228</sup> 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 146, 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 331-43 (for a brief discussion of 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* (work-in-progress).

<sup>229</sup> Hale, *Coercion*, supra note 146, at 471 (“to call an act coercive is not by any means to condemn it.”); *id.* at 474-78 (elaborating further); Patterson, supra note 212, at 742 (arguing that 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 (Implied threats “are an accepted part 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.”)

<sup>230</sup> See *supra* text accompanying note 61.

## *Smoke, Mirrors & Contract Law*

First, contract law does not enforce every promise a person makes. It only enforces some of them.<sup>231</sup> The state, through its courts, legislatures and agencies, therefore, determines which contracts will be enforced.<sup>232</sup> This determination necessarily requires courts and legislatures to make policy choices between competing principles and values, such as freedom and security.<sup>233</sup> These policy choices are matters of public concern. Here, the state (through its contract law and regulation/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>234</sup> Once it is acknowledged that the decision about contract enforceability comes down to a policy choice, nothing separates private law from public politics.<sup>235</sup>

Second, and specifically because the subprime loan in the hypothetical is legally enforceable, the state will step in to enforce the obligations contained in that contract by compelling Mary Smith, the borrower (through its judges, sheriffs and other state agents) to either pay to get out of it, perform it, or file bankruptcy as a result of it.<sup>236</sup> Thus, because the

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<sup>231</sup> Cohen, *Contract*, supra note 22, at 585; Singer, *Realism*, supra note 1, 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.

<sup>232</sup> Singer, *Realism*, supra note 1, at 485; see generally, Cohen, *Contract*, supra note 22.

<sup>233</sup> Singer, *Realism*, supra note 1, at 484-85; Feinman, *Critical*, supra note 63, at 841-42; Mensch, *Ideology*, supra note 204, at 759; see generally Cohen, *Contracts*, supra note 22.

<sup>234</sup> See, e.g., *Rogers v. American Brokers Conduit Countrywide Home Loans*, No. 2:09-CV-715 TS, 2009 U.S. Dist. WL 3584323 (D. Utah Oct. 26, 2009) (granting lender's motion to dismiss plaintiff's complaint); *Phillips v. MERS Mortgage Electronic Registration Systems*, No. 1:09-CV-01028-OWW-SMS, 2009 U.S. Dist. WL 3233865 (E.D. Cal. Oct 2, 2009) (granting lender's motion to dismiss plaintiff's complaint with prejudice); *Rangel v. DHI Mortg. Co., Ltd.*, No. CV F 09-1035 LJO GSA., 2009 U.S. Dist. WL 2190210, at \*1, 3-4, 12 (E.D. Cal. July 21, 2009) (granting lender's motion to dismiss plaintiff's complaint with prejudice). 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 faith, unfair lending practices, and wrongful foreclosure.

<sup>235</sup> 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. C.f. 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, and usually is, also made in court. See, e.g., Robert Mangabeira Unger, *The Critical Legal Studies Movement*, 96 *Harv. L. Rev.* 561, 565-66 (1983). Law, therefore, is really just an elaborate political ideology. Feinman, *Critical*, supra note 63, at 852. A good example of the "all law is politics" point is the different treatment given surrogacy contracts in different states with some states, like \_\_\_\_\_ finding them enforceable while other states, like \_\_\_\_\_, finding them unenforceable.

<sup>236</sup> Cohen, *Contract*, supra note 22 at 585-86; Singer, *Realism*, supra note 1, at 483-85. 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

state decides whether a given type of contract is enforceable<sup>237</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>238</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>239</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 impacts each person's ability to contract,<sup>240</sup> and ultimately decides which contracts will be enforceable.<sup>241</sup> Clearly, therefore, the state plays an active role in every contract and, as a result, its role is neither neutral nor minimal.<sup>242</sup> Indeed, and precisely because of 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>243</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>244</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>245</sup> Expected utility is usually defined in terms of the person's "self-interest".<sup>246</sup> "Self-

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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.

<sup>237</sup> See, e.g., *Shelley v. Kramer*, 334 U.S. 1, 18-19 (1948) (the Supreme Court held that when courts enforce racially restrictive covenants in real property contracts, they are engaged in state action, that is, using state power.)

<sup>238</sup> See supra Part III.A.1.

<sup>239</sup> See supra text accompanying note 68.

<sup>240</sup> See supra text accompanying notes 146-49, 205-07.

<sup>241</sup> See supra Part III.A.3.

<sup>242</sup> Singer, Realism, supra note 1, at 482; see also also Cohen, Property, supra note 142, at 11-13.

<sup>243</sup> This is, of course, yet another assumption of modern contract law that cannot be sustained. See supra text accompanying note 61 (laying out the assumption).

<sup>244</sup> See supra text accompanying note 63.

<sup>245</sup> Game theory ultimately led to a series of "decisionmaking principles or axioms that rational actors were expected to honor." Hanson & Kysar, supra note 115, 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 expected utility." Id. at 642. "Rational behavior," as a result, soon became synonymous with expected utility.

interest,” in turn, is commonly assumed to be wealth-maximization.<sup>247</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>248</sup> Unfortunately, none of this is true in general and not when it comes, more particularly, to contracts.<sup>249</sup>

Studies show, for example, that common form contract language is understandable only by people with college degrees,<sup>250</sup> which does not describe many contracting parties,<sup>251</sup> particularly consumers.<sup>252</sup> In addition, basic micro-economics continues to confirm that market

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Id. Thus:

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.

Id. at 643; Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 Cal. L. Rev. 1051, 1062 (2000) (noting that “expected utility theory” is the most dominant conception of rational choice theory in modern microeconomics); Hadfield, *supra* note 26, at 1254; Tanina Rostain, *Educating Homo Economicus: Cautionary Notes on the New Behavioral Law and Economics Movement*, (cite?) at 977; Willis, *supra* note 15, at 741..

<sup>246</sup> Korobkin & Ulen, *supra* note 245, 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 . . . .” The most common assumption, according to the authors, is “that actors will seek to maximize what is in their self-interest.”); Willis, *supra* note 15, at 741 (“The thicker versions of rational choice theory would add that consumers’ marketplace decisions reflect their own financial self-interest.”)

<sup>247</sup> Korobkin & Ulen, *supra* note 245, 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.”) (footnotes omitted); Rostain, *supra* note 245 at 977.

<sup>248</sup> See Willis, *supra* note 15, at 741-42.

<sup>249</sup> See Ben-Shahar & Schneider, *supra* note 97, at 38 (“mandated disclosure rests on the false assumptions that people want to make all the consequential decisions about their lives and 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.”)

<sup>250</sup> Ben-Shahar & Schneider, *supra* note 97, at 42 (“mandated disclosures are regularly written at forbidding reading levels. Financial privacy notices are written at third- or fourth-year college reading level.”)

<sup>251</sup> According to Ben-Shahar & Schneider, “over 40 million adults are functionally illiterate, ‘and another 50 million have marginal literacy skills.’” Ben-Shahar & Schneider, *supra* note 97, at 42 (citation omitted). Significantly, “[r]ates of innumeracy are even worse than rates of illiteracy.” Id.

<sup>252</sup> See Ben-Shahar & Schneider, *supra* note 97, at 43 (“only 3-4% of the population can understand the language in which contracts are drafted.”) (citation omitted); Garvin, *supra* note 116 at 15-16 & n.62 (discussing the different studies.)

*Smoke, Mirrors & Contract Law*

failure in the form of information asymmetries remain fairly common,<sup>253</sup> obtaining information imposes costs,<sup>254</sup> and parties do not have equal access to information.<sup>255</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>256</sup> where salience can be defined as prominent information that individuals actually pay attention to in making their rational contractual decisions.<sup>257</sup> What information is “salient,” therefore, will vary depending on the contractual context.<sup>258</sup>

Behavioral law and economics also tells us that individuals do not act rationally in the marketplace for many reasons.<sup>259</sup> I will touch on two. First, people are “boundedly rational,” which simply refers to the fact that human cognitive abilities are limited.<sup>260</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>261</sup> Second, people’s preferences are affected by the context in which the information is presented.<sup>262</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>263</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>264</sup>

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<sup>253</sup> Edward L. Rubin, *Types of Contracts, Interventions of Law*, 45 *Wayne L. Rev.* 1903, 1909-10 (2000) (noting that market failure in the form of information asymmetry occurs fairly frequently.)

<sup>254</sup> See, e.g., Rubin, *supra* note 253, 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.”); Garvin, *supra* note 116, at 14 (“As Herbert Simon has observed, both information and its assimilation are costly, so we must make decisions based on incomplete information.”); Bar-Gill & Warren, *supra* note 16, at 113.

<sup>255</sup> See, e.g., Kaplow & Shavell, *supra* note 115, at 36 (“It is a commonplace that consumer information is often imperfect . . . .”)

<sup>256</sup> Willis, *supra* note 15 at 19-20 (“ . . . most people use only four or five salient decision attributes in making complex decisions; beyond that number, decisionmaking quality goes down. When under stress, people reduce the number of attributes under consideration even more radically, to fewer attributes.”) (footnotes omitted).

<sup>257</sup> See, e.g., Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 *U. Chi. L. Rev.* 1203, 1206 (2003); C.f. Whitford, *Disclosure*, *supra* note 105, 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.”)

<sup>258</sup> See, e.g., Korobkin, *Bounded*, *supra* note 257, at 1225-44.

<sup>259</sup> See, generally, Korobkin, *Bounded*, *supra* note 257; Garvin, *supra* note 116.

<sup>260</sup> See Jolls, et al, *supra* note 87, at 1477.

<sup>261</sup> Garvin, *supra* note 116, at 14; Korobkin & Ulen, *supra* note 245, at 1143.

<sup>262</sup> Rostain, *supra* note 245, 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.”

<sup>263</sup> Hanson & Kysar, *supra* note 115, at 644 (discussing the work/studies of Tversky and Kahneman); Rostain, *supra* note 245, at 978 (“experimental evidence establishes that preferences depend importantly on how the choices are described.”)

<sup>264</sup> See, e.g., Jolls, et al, *supra* note 87, at 1534; Hanson & Kysar, *supra* note 115, at 685.

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>265</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>266</sup> and her final TILA and RESPA disclosures at loan closing.<sup>267</sup> Practically speaking, this also means that Ms. Smith probably did not read the disclosures, let alone the loan documents.<sup>268</sup> Even if she did read them she, like most consumers, probably would not have understood them,<sup>269</sup> because the disclosures are extremely complicated.<sup>270</sup> And, because she didn't understand them, Ms. Smith would have been unable to shop for better terms.<sup>271</sup>

In addition, the loan documents would have been framed in a way that downplayed the risks of the loan;<sup>272</sup> the only salient piece of information Ms. Smith probably focused on was the monthly payment;<sup>273</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>274</sup>

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<sup>265</sup> See supra text accompanying notes 4-19.

<sup>266</sup> Willis, supra note 15, at 745.

<sup>267</sup> Willis, supra note 15, at 747.

<sup>268</sup> C.f. Ben-Shahar, *Myth*, supra note 133, at 1 (“Real people don’t read standard form contracts.”)

<sup>269</sup> See generally Willis, supra note 15, at 751-54 (discussing consumers’ financial illiteracy); *id.* at 763-64 (arguing that financial illiteracy is a bigger problem for subprime loan borrowers.); Bar-Gill & Warren, supra note 16, at 129 (“A recent FTC survey found that many consumers do not understand, or even identify, key mortgage terms.”) (footnote omitted). See also *infra* note \_\_\_\_.

<sup>270</sup> Willis, supra note 15, at 752 (“The disclosures are not presented in simple enough lay terms and many borrowers ignore the disclosures as incomprehensible legally mandated gobbledygook.”); Bar-Gill & Warren, supra note 16, at 127-129 (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. This finding was confirmed by a 2006 study by the United States Government Accountability Office and other studies as well.); see generally Bar-Gill, supra note 5, at Part II.B.

<sup>271</sup> Willis, supra note 15, at 749-54; c.f. Bar-Gill & Warren, supra note 16, at 131 (“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.”)

<sup>272</sup> Willis, supra note 15, at 785-88; c.f. Bar-Gill & Warren, supra note 16, at 153, 154 (noting that mortgage products defer a lot of the loan’s actual costs into the future and the disaggregation of fees in mortgage loans).

<sup>273</sup> Willis, supra note 15, at 780, 788; c.f. Bar-Gill & Warren, supra note 16, at 129 (citing an FTC survey that found that “many consumers do not understand, or even identify, key mortgage terms.”)

<sup>274</sup> Willis, supra note 15, at 776-79. Indeed Professor Bar-Gill notes that:

Imperfectly 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.

*Smoke, Mirrors & Contract Law*

In short, people simply do not rank their preferences based on their expected net-utility, because they can't.<sup>275</sup> In other words, people do not act rationally in the market in the ways that modern contract law presupposes that they do.<sup>276</sup> As a result, contracts are not the product of rational choice, nor are they the product of informed choice, despite modern contract law's assertions to the contrary.<sup>277</sup>

Notwithstanding that the modern contract law system's rational actor assumption is flawed in theory and in practice, it presents yet another opportunity for modern contract law to show that it is a self-legitimizing system.<sup>278</sup> Forced to acknowledge that people do, in fact, enter into contracts that cannot be explained as exercises of rationality, modern contract law 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>279</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>280</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 once again that people will act rationally in the marketplace. Hence, the rational actor assumption is re-affirmed and thereby re-legitimized, 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.

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Bar-Gill, *supra* note 5, at 1079 (citation omitted).

<sup>275</sup> See Rostain, *supra* note 245, 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.”)

<sup>276</sup> See *supra* text accompanying notes 245-49. 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.”

<sup>277</sup> See *supra* text accompanying notes 63-64.

<sup>278</sup> See *supra* text accompanying notes 92-104. I need to thank my friend and colleague, Professor Katherine C. Sheehan, for helping me work out this argument.

<sup>279</sup> See Ben-Shahar & Schneider, *supra* note 97, at 4 (mandatory disclosure “rests on a plausible assumption: that in making decisions, more information is better than less. More information helps people make better decisions, thus bolstering their autonomy.”) See also *supra* text accompanying notes \_\_\_-\_\_\_.

<sup>280</sup> See *infra* Part IV.B.

## **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>281</sup> As with all of the other assumptions, this one is also contestable in theory and practice, because all contracts are relational.<sup>282</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>283</sup> they are not going to have an on-going 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>284</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 theory.<sup>285</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>286</sup> and in a particular social context.

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<sup>281</sup> See supra text accompanying note 62.

<sup>282</sup> Contracts tend to fall along a relational-discrete continuum, that is, 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*]; William C. Whitford, *Ian Macneil's Contribution to Contracts Scholarship*, 1985 *Wis. L. Rev.* 546 [hereinafter Whitford, *Contribution*]; Feinman, *Relational*, supra note 53, at 739. Notwithstanding this continuum, all contracts are relational because even the most "discrete" contract contains relational elements. See infra text accompanying notes 285-311.

<sup>283</sup> See, e.g., Willis, supra note 15, at 790 ("Settlement officers typically schedule home loan closings every thirty minutes[.]")

<sup>284</sup> See Whitford, *Contribution*, supra note 282, at 546 ("contracts occurring between parties who have little interaction other than the contract itself tend to fall on the discrete end of the relational-discrete continuum."); Feinman, *Theory*, supra note 41, at (text before n75) ("Some exchanges are relatively discrete, involving short duration, limited party interactions, and precise measurement of the value of the objects exchanged.")

<sup>285</sup> What follows is actually a very limited analysis of relational contract theory. Professor Macneil spent decades developing, articulating, refining, and advocating his theory. See, Ian R. Macneil, *Relational Contract Theory: Challenges and Queries*, 94 *Nw. U. L. Rev.* 877 (2000) [hereinafter Macneil, *Challenges*]. For a more in-depth treatment, see Ian MacNeil, *Contracts: Adjustment of Long-Term Economic Relations Under Classical, Modern and Relational Contract Law*, 72 *Nw. U. L. Rev.* 854 (1978); Ian MacNeil, *The New Social Contract* (1980); Ian MacNeil, *Values in Contract: Internal and External*, 78 *Nw. U. L. Rev.* 340 (1983) [hereinafter, Macneil, "Values"]; Ian MacNeil, *Relational Contract Theory as Sociology: A Reply to Professors Lindenberg and de Vos*, 143 *J. Inst'l & Theor'l Econ.* 272 (1987). Figuring out what constitutes a "relational contract," therefore, would only be a beginning. See Whitford, *Contribution*, supra note 282, at 545 (referring to Professor Macneil's relational contract theory as a "general theory of the social order.").

<sup>286</sup> Ian R. Macneil, *Values*, supra note 285, at 344.

*Smoke, Mirrors & Contract Law*

To Macneil, contracts are exchange relations<sup>287</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>288</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 given contract, therefore, it must be situated within the framework of the non-discrete relations, what Professor Macneil calls the “enveloping relations,”<sup>289</sup> that encompass it. This means, at a minimum, that the social context (i.e., its enveloping relations) must be understood.<sup>290</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>291</sup> Determining what the social context or enveloping relations are in a given transaction is an open question,<sup>292</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>293</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. He argues first that the “sales of bananas occur in

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<sup>287</sup> Macneil, *Challenges*, supra note 282, at 878 (“‘contract’ means relations among people who have exchanged, are exchanging, or expect to be exchanging in the future—in other words, exchange relations.”) (citation omitted).

<sup>288</sup> Macneil, *Challenges*, supra note 282, at 884.

<sup>289</sup> Macneil, *Challenges*, supra note 282, at 881, 884.

<sup>290</sup> Macneil, *Challenges*, supra note 282, at 884.

<sup>291</sup> *Id.*

<sup>292</sup> Macneil acknowledges that “where to stop” in deciding which elements of the enveloping relations should be considered is a question. Macneil, *Challenges*, supra note 282, 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).

<sup>293</sup> Macneil, *Challenges*, supra note 282, at 884-85.

extremely complicated supermarket-customer relationships[.]”<sup>294</sup> and he sets that relationship out in some detail.<sup>295</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:

banana 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 v. small Caribbean island countries, particularly non-Chiquita-like producers), and European v. 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>296</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), and 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/deregulation of the American financial market permitted subprime loans to be marketed and sold,<sup>297</sup> and allowed the creation and sale of mortgage backed securities;<sup>298</sup> the fact that Ms.

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<sup>294</sup> Macneil, *Challenges*, supra note 282, at 885.

<sup>295</sup> Thus, he 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.

Macneil, *Challenges*, supra note 282, at 885.

<sup>296</sup> Macneil, *Challenges*, supra note 282, at 885.

<sup>297</sup> See, supra, text accompanying notes \_\_\_-\_\_.

Smith's subprime loan was most likely bundled with other CitiMortgage originated subprime loans and either sold or mortgaged as a mortgage backed security to various types of investors;<sup>299</sup> 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; and conflicting understandings of the obligations of the lender, with the law saying that lenders: (i) owe no fiduciary duty to borrowers;<sup>300</sup> (ii) have no duty to disclose whether borrowers actually qualify for the loans they are sold;<sup>301</sup> (iii) have no duty to determine the borrowers' ability to repay the loan;<sup>302</sup> (iv) have no duty to refrain from making loans to borrowers whom the lenders

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<sup>298</sup> 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 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 5, at 1090-91.

<sup>299</sup> See Bar-Gill, *supra* note 5, at 1088 n.33 (analyzing 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*, at 6 & n.6, 7 tbl.1 (available on SSRN at <http://papers.ssrn.com/sol3/results.cfm?RequestTimeout=50000000>).

<sup>300</sup> *Pimetal v. Wachovia Mortg. Corp.*, 411 F. Supp. 2d 32, 39 (D. Mass. 2006) (holding that lenders owe no fiduciary duty to borrowers.); *Oaks Management Corporation v. Superior Court*, 145 Cal.App.4th 453, 466, 51 Cal.Rptr.3d 561 (2006) ("[I]t is established that absent special circumstances ... a loan transaction is at arm's length and there is no fiduciary relationship between the borrower and lender.") (collecting cases); *Nymark v. Heart Fed. Savings & Loan Assn.*, 231 Cal.App.3d 1089, 1093 n. 1, 283 Cal.Rptr. 53 (1991) (rejecting breach of fiduciary duty claim by borrower and holding instead that the claim failed as a matter of law. "The relationship between a lending institution and its borrower-client is not fiduciary in nature." *Price v. Wells Fargo Bank* (1989) 213 Cal.App.3d 465, 476-478 [261 Cal.Rptr. 735]. "A commercial lender is entitled to pursue its own economic interests in a loan transaction." *Kruse v. Bank of America* (1988) 202 Cal.App.3d 38, 67 [248 Cal.Rptr. 217]. "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." ( *Committee on Children's Television, Inc. v. General Foods Corp.* (1983) 35 Cal.3d 197, 221 [197 Cal.Rptr. 783, 673 P.2d 660].); *Lawrence v. Bank of America* 163 Cal.App.3d 431, 437 (Cal.App.1.Dist.1985) ("under ordinary circumstances the relationship between a bank and its depositor is that of debtor-creditor, and is not a fiduciary one[.]")

<sup>301</sup> *Cross v. Downey Savings and Loan Ass'n*, 2009 U.S. Dist. WL 481482, at \*9, (E.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.); *C.f. Nymark v. Heart Fed. Savings & Loan Ass'n*, 231 Cal.App.3d 1089, 1096 (1991) ("as 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.")

<sup>302</sup> *Renteria v. U.S.*, 452 F.Supp.2d 910, 922-23 (D. Ariz. 2006) (stating that "the 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," but no such duty exists; "the lender's efforts to determine the creditworthiness and ability to repay by a borrower are for the

*Smoke, Mirrors & Contract Law*

know cannot repay the loan;<sup>303</sup> and (v) have no duty to give borrowers the best rates,<sup>304</sup> which is, of course, contrary to the understanding held by a majority of borrowers.<sup>305</sup>

What the discussion of the social matrix and social context applicable to the home mortgage loan between CitiMortgage and Mary Smith demonstrate, 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[;] . . . a person who is not a member of the family, group, community, or the like . . . [,]" while "arm's length" means not closely or intimately connected or associated[.]"<sup>306</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 a system of order.<sup>307</sup> In addition, a myriad of customs (i.e., one should be on time for appointments or one should pay one's bills), understandings (spoken or unspoken and legal or not),<sup>308</sup> as well as laws and regulations<sup>309</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>310</sup> Consequently, and contrary to modern contract law's assumption,<sup>311</sup> there simply are no strangers in a given society and an arm's length transaction is an oxymoron.

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lender's protection, not the borrower's;"); *Anderson v. Franklin*, No. 2:09-cv-11096, 2010 U.S. Dist. WL 742765, at \*8 (E.D. Mich. Feb. 26, 2010) (noting that the world might be a better place "if lenders had a duty to the borrower to determine the borrower's ability to repay the loan"); *Norwich Sav. Society v. Caldrello*, No. CV89-512204, 1993 Superior Court of Connecticut, Judicial District of New London WL 268512, at \*9 (Conn. Super. Ct. July 12, 1993) (stating that "a bank does not have a duty to investigate a borrower's ability to repay the loan").

<sup>303</sup> *Northern Trust Co. v. VIII South Michigan Assocs.*, 657 N.E.2d 1095, 1102 (Ill. App. Ct. 1995) (stating that the lender "has no duty to refrain from making a loan if the lender knows or should know that the borrower cannot repay the loan"); *Wagner v. Benson*, 101 Cal.App.3d 27, 35 (1980) (holding that the lenders did not owe a duty of care to the borrowers in approving the loan).

<sup>304</sup> See, e.g., 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.)

<sup>305</sup> See Bar-Gill & Warren, *supra* note 16, at 132 ("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.")

<sup>306</sup> Dictionary.com (7/29/10).

<sup>307</sup> See *supra* text accompanying note 288 (laying out Macneil's social matrix)

<sup>308</sup> See *supra* text accompanying notes \_\_\_-\_\_.

<sup>309</sup> See *supra* Part III.A.1.

<sup>310</sup> Macneil, *Values*, *supra* note 285 at 345.

<sup>311</sup> See *supra* text accompanying note 62.

## **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>312</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>313</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>314</sup>

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>315</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 over-broad. 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>316</sup> to include *anything*—resources (money, time, staff), experience, expertise, knowledge, etc.—that gives one party a bargaining advantage over the other party.<sup>317</sup>

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<sup>312</sup> See *infra* Part IV.B.

<sup>313</sup> See *supra* text accompanying notes 69-91.

<sup>314</sup> See *supra* text accompanying notes 30-31 (discussing the distinction between state power and unmitigated state power).

<sup>315</sup> I need to thank my friend, Professor Nancy Kim, for bringing this issue to my attention.

<sup>316</sup> See Daniel D. Barnhizer, “Bargaining Power in Contract Theory,” in *Visions of Contract Theory*, at 92 (2007) (According to Barnhizer, “[a] party has bargaining power if she has the ability to effect intelligently a preferred outcome in a bargaining relationship.”) (citation omitted) [hereinafter, Barnhizer, “Bargaining Power”].

<sup>317</sup> Some scholars appear to distinguish party sophistication from bargaining power. See, generally, Miller, *supra* note 59. The distinction turns on the definition of a “sophisticated party.” See, generally, *id.* at 494 (“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.”) (citation omitted). I think it is entirely possible that the sophistication of the contracting parties is at least an element of bargaining

*Smoke, Mirrors & Contract Law*

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 “free from prejudice, favoritism, and self-interest . . . ; even-handed; equal, as between conflicting interests.”<sup>318</sup> To some economists, “fairness” suggests that “some legal opportunities for gain are not exploited.”<sup>319</sup> To non-economists, “fairness” is a way to incorporate other regarding preferences.<sup>320</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>321</sup> Implicit in Rawls’ 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>322</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’ veil of ignorance.<sup>323</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>324</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>325</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

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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.

<sup>318</sup> Black’s Law Dictionary 307 (Abridged 5<sup>th</sup> ed. 1983).

<sup>319</sup> Daniel Kahneman, Jack L. Knetsch & Richard H. Thaler, Fairness and the Assumptions of Economics, 59 J. BUS. S285, S286 (1986).

<sup>320</sup> Michael B. Dorff & Kimberly Kessler Ferzan, The Perils of Forgetting Fairness, 59 Case Western L. Rev. 597, 606 (2009).

<sup>321</sup> John Rawls, Political Liberalism xlv (1996).

<sup>322</sup> Rawls, Political Liberalism, supra note 321, at xlv.

<sup>323</sup> John Rawls, A Theory of Justice 11 (defined), §24:118-23 (extended discussion) (revised ed. 1999).

<sup>324</sup> See Singer, Standards, supra note 143, at 159.

<sup>325</sup> Hart, supra note 21, at 179 n.14.

## *Smoke, Mirrors & Contract Law*

favor one of the contracting parties. The pivot 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 unfair. In other words, a bad bargain would represent a contract on “unfair” terms.<sup>326</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 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>327</sup> and, for reasons discussed earlier, it is extremely difficult to overcome this presumption.<sup>328</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>329</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>330</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>331</sup>

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<sup>326</sup> 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.

<sup>327</sup> See supra text accompanying notes 74-91.

<sup>328</sup> See supra text accompanying notes 74-91.

<sup>329</sup> See supra text accompanying notes 87-89.

<sup>330</sup> See supra text accompanying notes 61-68.

<sup>331</sup> See U.C.C. §2-204(1) (date) (“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, or may be inferred wholly or partly from conduct.”); RESTATEMENT (SECOND) OF CONTRACTS § 19(1) (1981) (“The manifestation of assent may be made wholly or partly by written or spoken words or by other acts or by a failure to act.”).

## *Smoke, Mirrors & Contract Law*

All of modern contract law's assumptions are ostensibly at work in making this simple contract binding.<sup>332</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>333</sup> manufacturing and safety, as well as extensive involvement by agencies, such as the United States Department of Agriculture and the federal Food and Drug Administration. Consequently, the market for the sale of a candy bar is inseparable from the laws that create it. 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>334</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 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>335</sup> The state also says that a sale of goods, like the sale of a candy bar, is enforceable<sup>336</sup> and would be enforced by the state through, for example, its shop lifting laws. Hence, because the state decides whether the contract for the candy bar is enforceable and will actually enforce this contract,<sup>337</sup> the contract for the sale of the candy bar is public, not private.

Given that the state was actively involved in creating the market for the sale of the candy bar, ultimately decides whether the contract for the candy bar is enforceable, and for other reasons as well,<sup>338</sup> it would be very difficult to say that the state's role in this contract is neutral or minimal. For this reason, the state 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.

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<sup>332</sup> See supra text accompanying notes 61-68 (listing the assumptions).

<sup>333</sup> See, e.g., The Nutrition Labeling and Education Act (Public Law 101-535) (1990).

<sup>334</sup> See supra text accompanying notes 203-10.

<sup>335</sup> See supra note 331 (cites for contracts formed by conduct).

<sup>336</sup> See generally Article 2 (Sales) of the Uniform Commercial Code.

<sup>337</sup> See Part III.A.3.

<sup>338</sup> See Part III.A.4.

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>339</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 most people who purchase candy bars.<sup>340</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.

Finally, the parties did not bargain at arm's-length, nor were they strangers to one another because of the social matrix<sup>341</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>342</sup> within which the sale took place.<sup>343</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, as well as 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 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>344</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.

#### **IV. 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

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<sup>339</sup> See supra text accompanying notes 244-48 (discussing modern contract law's rational actor).

<sup>340</sup> C.f. Ben-Shahar, Myth, supra note 133, at 3 ("Apart from an exotic individual here or there, nobody reads.")

<sup>341</sup> See supra text accompanying notes 287-88.

<sup>342</sup> See supra text accompanying notes 289-96 (explaining "social context").

<sup>343</sup> The social context for the sale of the candy bar would be fairly analogous to Professor Macneil's example of the sale of bananas in a supermarket. See supra text accompanying notes 294-95.

<sup>344</sup> See also supra Part III.A.

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. The argument explored in this Part, however, is that by making contracts binding, this premise ensures that unequal bargaining power is a systemic and structural feature of the modern contract law system. Part IV.A. links Part III. and Part IV. by establishing the synergistic relationship between state power and unequal bargaining power. Part IV.B. develops the specific argument that modern contract law institutionalizes unequal bargaining power and reveals the negative consequences this conclusion has for contract law itself. Part IV.C., then exposes the systemic implications for the modern contract law system of the system's continued adherence to assumptions that cannot be sustained, its reliance on the premise that contracts are binding and the institutionalization of unequal bargaining power.

### **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>345</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>346</sup> Recall, the state determines property rights. 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>347</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>348</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.

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<sup>345</sup> See supra Part III.A.

<sup>346</sup> See supra text accompanying notes 146-50, 207-10.

<sup>347</sup> See supra text accompanying notes 147-49, 208.

<sup>348</sup> See supra Part II.A.

## **B. Institutionalizing Unequal Bargaining Power**

Regardless of its source, unequal bargaining power exists.<sup>349</sup> Unequal bargaining power poses difficulties for modern contract law when it is used, for example, to obtain a bad bargain. 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>350</sup> Indeed, this structural aspect of modern contract law is partly what gives rise to the presumption of contract validity.<sup>351</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. Second, the tools modern contract law relies upon to address unequal bargaining power are ineffective.<sup>352</sup>

Because unequal bargaining power is not effectively addressed, its use and abuse within the modern contract law system remain 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>353</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>354</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.

Unfortunately, disclosure statutes are premised on the same assumptions that make up the framework for modern contract law.<sup>355</sup> As previously discussed in detail, all of these assumptions are fallacious.<sup>356</sup> As a direct result, disclosure statutes will not work.<sup>357</sup> In fact,

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<sup>349</sup> Barnhizer, *Inequality*, supra note 23, at 240.

<sup>350</sup> See supra note 79 (contract interpretation) and 79-80 (defenses to enforcement).

<sup>351</sup> See supra text accompanying notes 74-91.

<sup>352</sup> See Hart, supra note 21 at Part \_\_ (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 plus bad bargain problem).

<sup>353</sup> "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.

<sup>354</sup> See Restatement (Second) of Contracts §17(1); Restatement (Second) of Contracts §22(1); see also, supra, text accompanying notes 70, 72.

<sup>355</sup> See supra text accompanying notes 61-68.

<sup>356</sup> See supra Part III.A.

<sup>357</sup> See generally Ben-Shahar & Schneider, supra note 97, at 15-54 (Part II—documenting the failure of mandated disclosure and Part III—laying out in detail why mandatory disclosure does not work).

empirical studies support this conclusion.<sup>358</sup> They will not remedy unequal bargaining power in the form of information asymmetries. 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>359</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>360</sup>

The more perverse outcome,<sup>361</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>362</sup>

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<sup>358</sup> For example, Professor Florencia Marotta-Wurgler recently conducted empirical research to examine the “informed minority” justification for disclosure statutes. Florencia Marotta-Wurgler, *Does Disclosure Matter?* (paper on file with author) Her study made two main findings: (1) increasing contract accessibility did not result in an economically significant increase in contract readership; *Id.* at 3, 16-25 (empirical support), 29; 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 3, 25 (empirical support), 29. 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 29. 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 105, at 430-31 (focusing on Truth-in-Lending in an early attempt to assess whether disclosure statutes are effective in accomplishing their purposes; Whitford tentatively concluded, both empirically and theoretically, that disclosure statutes would have little impact.) See also Marotta-Wurgler, *Disclosure*, at 7-8 (citing prior empirical evidence on the effectiveness of disclosure regimes).

<sup>359</sup> See *supra* text accompanying notes 74-91 (discussing the presumption of contract validity).

<sup>360</sup> C.f. Ben-Shahar, *Myth*, *supra* note 133, at 1-2 (noting in the context of the “opportunity to read” that, “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.”)

<sup>361</sup> See Ben-Shahar & Schneider, *supra* note 97, at 59-60 (“mandated disclosure can undermine other consumer-protection regulations[,]” citing unconscionability specifically.); C.f. Marotta-Wurgler, *Disclosure*, *supra* note \_\_, at 6 (“courts 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.”)

<sup>362</sup> 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). 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 80-81; and, consequently, (2) they are all subject to a “process problem” that makes raising any of these doctrines successfully in litigation unlikely. See Hart, *supra* note 21, at 210-16 (discussing the “process problem” in detail). See, *supra* text accompanying notes 74-91. See also

*Smoke, Mirrors & Contract Law*

For example, a claim that the implied obligation of good faith was breached would probably fail, because the term was disclosed up front.<sup>363</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>364</sup> would also likely fail, because there would arguably be no fraudulent or material misrepresentation.<sup>365</sup>

In all likelihood, an unconscionability<sup>366</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>367</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>368</sup> The party raising unconscionability either as a claim or defense usually must prove both procedural and substantive unconscionability, to prevail.<sup>369</sup>

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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 45, at 110 (Morant argues that “[t]he existence of regulatory devices [like] duress, unconscionability, and undue influence cannot . . . sufficiently accommodate marketplace inequities.” He points to the “dearth of cases where individuals are successful in obtaining relief through those devices substantiates this point.” Indeed, Morant claims that “[t]his result is compounded by the heavy burden of proof placed upon the claimant of such relief.”); C.f. 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.”)

<sup>363</sup>See supra note 109 (discussing Robert Summers’ interpretation of the good faith requirement as requiring disclosure). For a much more expansive interpretation of good faith, however, see generally Houh, supra note 109.

<sup>364</sup> See, e.g., Restatement (Second) of Contracts §161. (When Non-Disclosure is Equivalent to an Assertion).

<sup>365</sup> A contract claim for misrepresentation requires a fraudulent or material misrepresentation. See Restatement (Second) of Contracts §164. By definition, a misrepresentation, whether fraudulent or material, presupposes that a “false” statement is being made. See Black’s Law Dictionary (Second Pocket Edition) (2001). 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 300-05.

<sup>366</sup> See Restatement (Second) of Contracts §208 (Unconscionable Contract or Term); Uniform Commercial Code §2-302 (Unconscionable Contract or Clause).

<sup>367</sup> C.f. Robert A. Hillman, On-Line Boilerplate: Would Mandatory Website Disclosure of E-Standard Terms Backfire?, 104 Mich. L. Rev. 837 (2006) (making the same argument regarding unconscionability in the context of on-line contracting).

<sup>368</sup> According to Professor Lauren Willis, the HUD-Treasury Report states: “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.” Willis, supra note 15, at 798 (citation omitted).

<sup>369</sup> See, e.g., A & M Produce Co. v. FMC Corp., 135 Cal. App. 3d 473, 485-86 (1982); Arthur Allen Leff, Unconscionability and the Code - The Emperor's New Clause, 115 U. Pa. L. Rev. 485, 487-488 (1967). But see Gillman v. Chase Manhattan Bank, N. A., 73 N.Y.2d 1, 12 (1998) (“While determinations of unconscionability are ordinarily based on the court's conclusion that both the procedural and substantive components are present (see,

## *Smoke, Mirrors & Contract Law*

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>370</sup> and (2) increase the power 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>371</sup> In the hypothetical subprime loan transaction between CitiMortgage and Mary Smith,<sup>372</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>373</sup> on Mary Smith, because it could do so with little risk of liability.<sup>374</sup>

One could argue in response to the hypothetical in general that using a subprime mortgage loan is the wrong example.<sup>375</sup> The real problem is not the high cost subprime loan, but

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Matter of State of New York v Avco Fin. Serv., supra, at 389), 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 (see, State of New York v Wolowitz, 96 AD2d 47, 68, supra; White and Summers, Uniform Commercial Code § 4-7, at 164, 165 [2d ed].)"' State v. Wolowitz, 96 A.D.2d 47, 68 (N.Y. Sup. Ct. 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., [\*\*\*46] Jones v Star Credit Corp., 59 Misc 2d 189, 192), such cases are the exception.")).

<sup>370</sup> This is because any subsequent challenge to the validity of the terms added during formation will likely fail.

<sup>371</sup> See generally, Hart, supra note 21; see also text accompanying notes 361-69.

<sup>372</sup> See supra text accompanying notes 4-19.

<sup>373</sup> See supra text accompanying notes 15-19.

<sup>374</sup> There is low risk of liability to CitiMortgage, because of compliance with the disclosure statutes and the presumption of contract validity.

<sup>375</sup> 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,

rather than the American financial market crashed.<sup>376</sup> Both parties—CitiMortgage and Mary Smith—ended up doing very badly as a result of it. While this 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>377</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, *only* ran into trouble because the financial market crashed, not because of the subprime loan it sold to Mary Smith.<sup>378</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>379</sup> The crux of Mary Smith’s problem, therefore, stems from the subprime loan contract itself.<sup>380</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>381</sup> here, Mary Smith. Given that it is extremely difficult to overcome the presumption of contract

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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 IV.C.

<sup>376</sup> 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 Vega, in February.

<sup>377</sup> See *supra* text accompanying notes 4-19 (laying out the hypothetical).

<sup>378</sup> Former Citigroup chief executive officer Charles Prince and former chairman of the board Robert Rubin admitted as much in recent testimony before Financial Crisis Inquiry Commission. Mr. Prince stated that, "I'm sorry that our management team, starting with me, like so many others, did not see the unprecedented market collapse that lay before us." Mr. Rubin testified in a similar vein when he stated that, "Almost all 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[.] We all bear responsibility for not recognizing this, and I deeply regret that." LA Times online: "Former Top Citigroup Executives Apologize for the Financial Crisis," by Jim Puzzanghera (April 8, 2010) at <http://www.latimes.com/business/la-fi-citi-bailout9-2010apr09.0.3260780.story>

<sup>379</sup> See *supra* text accompanying notes 15-19 (terms of the loan).

<sup>380</sup> 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 also text accompanying note 15 (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 the upward adjustment of their adjustable rate mortgages).

<sup>381</sup> See *supra* text accompanying notes 77-78; see generally, Hart, *supra* note 21, at 204-16.

*Smoke, Mirrors & Contract Law*

validity in practice,<sup>382</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>383</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>384</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 most cases involving subprime home mortgages will not end up in court<sup>385</sup> and, therefore, subject to public scrutiny. Even if an attorney or legal service provider agreed to take the case, modern contract law's solutions, namely, the contract policing and defense to performance doctrines, would be ineffective or unavailable in most cases to resolve the problem.<sup>386</sup> As a result, CitiMortgage's abuse of its

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<sup>382</sup> See supra text accompanying notes 87-89; see generally, Hart, supra note 21, at 210-16.

<sup>383</sup> In fact, it has already been established that subprime loans are enforceable. See supra text accompanying notes 231-34.

<sup>384</sup> Hillman, supra note \_\_\_\_, at 853-55.

<sup>385</sup> Such cases would not end up in court either because the vast majority of cases in general are not taken to court or the loan contracts contain mandatory arbitration provisions.

<sup>386</sup> 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 361-69 (discussing the policing doctrines potentially affected); (b) the contract policing doctrines are not generally successful when they are raised, see DiMatteo & Rich, supra note 362, at 1097 ("Data revealed that in only 37.8% (56 out of 148) of the cases sampled unconscionability was found."); Giesel, supra note 362, at 463-65 (2005) (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 77-86 (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, respectively. 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. See *Karl Wendt Farm Equip. Co., Inc. v. Int'l Harvester Co.*, 931 F.2d 1112, 1117-18 (6th Cir. Mich. 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 Dissolution of F Yeager Bridge & Culvert Co.*, 150 Mich. App. 386, 398 (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

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 (Mary Smith) with impunity.

### **C. Smoke & Mirrors**

Power is ubiquitous; it exists everywhere.<sup>387</sup> This is not an original conclusion. The Legal Realists,<sup>388</sup> Critical Legal Studies,<sup>389</sup> feminism,<sup>390</sup> and more “other-oriented” social justice theories such as Critical Race Theory<sup>391</sup> and Queer Legal Theory<sup>392</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>393</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>394</sup> and institutionalizes unequal bargaining power.<sup>395</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>396</sup> In so doing, disclosure statutes obscure other more problematic forms of

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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”).

<sup>387</sup> Barnhizer, *Inequality*, supra note 23, at 142 (“power is omnipresent in human relations—every actor has power of some kind and to some degree.”)

<sup>388</sup> See supra Parts III.A.1 and III.A.2.

<sup>389</sup> See supra note 235 (discussing “all law is politics”).

<sup>390</sup> See, e.g., Catharine A. MacKinnon, *Toward a Feminist Theory of the State* (1989); Simone de Beauvoir, *The Second Sex* (1953).

<sup>391</sup> See, e.g., 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); Ian F. Haney Lopez, *White By Law* (1996).

<sup>392</sup> 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)

<sup>393</sup> See Barnhizer, *Inequality*, supra note 23, at 141 (“American contract law rarely acknowledges power explicitly[.]”)

<sup>394</sup> See supra Part III.A.

<sup>395</sup> See supra Part IV.B.

<sup>396</sup> See Ben-Shahar & Schneider, supra note 97, at 48 (“mandated disclosure is fundamentally misconceived because its solution to the problem of choice is information alone, but people’s problems with their choices go well beyond informational insufficiency.”); Willis, supra note 15, at 743 (“The disclosure regime admits of some

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>397</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>398</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>399</sup>

Significantly, disclosure statutes also operate as a safety valve for the modern contract law system. They show that we have identified a problem (i.e., bargaining inequalities in the form of information asymmetries) and, importantly that we're doing *something* to address it.<sup>400</sup> That this something we came up with, i.e., disclosure statutes, does not work very effectively is generally ignored,<sup>401</sup> and, quite frankly, is largely beside the point.<sup>402</sup> The point is that *something* is being done. Disclosure statutes, therefore, provide a visible, but ineffective fix for very real contracting problems; and, in so doing, disclosure statutes diffuse the call or drive for alternative ways, like substantive regulation or maybe even market-based solutions,<sup>403</sup> to address problems in contracting.<sup>404</sup> The modern contract law system is therefore able to alleviate

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boundedness to consumer rationality . . . but concludes that the main correction the market needs is informational.”) See also *supra* text accompanying notes 113-16, 132.

<sup>397</sup> See, e.g., Ian Ayres, “Fair Driving: Gender & Race Discrimination in Retail Car Negotiations” 104 Harv. L. Rev. 817 (1991) (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 (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* (empirical research documenting racial bias in the professional basketball market (i.e., the NBA)); see also *supra* note \_\_\_ (citing studies finding that women of color were disproportionately sold subprime loans).

<sup>398</sup> See *supra* text accompanying notes 361-69.

<sup>399</sup> C.f. Marotta-Wurgler, *Disclosure*, *supra* note 114, at 29 (“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.”)

<sup>400</sup> 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 367, at 23.

<sup>401</sup> Willis, *supra* note 15 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).

<sup>402</sup> C.f. Ben-Shahar & Schneider, *supra* note 97, at 24 (“mandated disclosure looks effective.”)

<sup>403</sup> See Ben-Shahar, *Myth*, *supra* note 133, at 27-33 (suggesting rating of contracts and labeling as possible market mechanisms “to provide some degree of informed-ness.”)

<sup>404</sup> See Hillman, *Boilerplate*, *supra* note 367, at 23 (“disclosure may inadvertently forestall other attempts at reform.”); Ben-Shahar, *Myth*, *supra* note 133, at 6 (“the presumption of assent that accompanies pre-disclosed terms assuages the need to develop other protections[.]”); Ben-Shahar & Schneider, *supra* note 97, at 60 (“Mandated disclosure may not only undermine other protections, it may inhibit their development.”); Marotta-Wurgler,

### *Smoke, Mirrors & Contract Law*

pressure on itself by providing a quick fix which, in turn, enables the system as a whole to continue unexamined and unchecked.<sup>405</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>406</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>407</sup> CitiMortgage sold Mary Smith a loan with terms that unreasonably favored it and which modern contract law will likely enforce. 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 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 over time, i.e., money in this example, which, in turn, further increases CitiMortgage's unequal bargaining power.<sup>408</sup>

Significantly, modern contract law, particularly its formation rules, legitimates 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.

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Disclosure, *supra* note 114, at 6 ("courts 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.")

<sup>405</sup> See also *supra* text accompanying notes 278-80 (discussing rational actor assumption and use of disclosure statutes to re-legitimize that assumption).

<sup>406</sup> See generally *supra* Part IV.A. (discussing the synergism).

<sup>407</sup> See *supra* note 11 (citing studies finding that women of color were disproportionately sold subprime loans).

<sup>408</sup> 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 of no consumer protection regulation.

In fact, however, both working together—modern contract’s formation rules and the disclosure statutes—simultaneously 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>409</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.

## V. 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, 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>410</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.

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<sup>409</sup> See *supra* text accompanying notes 92-104.

<sup>410</sup> 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.”); 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.”); 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.”)

*Smoke, Mirrors & Contract Law*

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 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>411</sup> We could consider constructing and adopting a bargaining power analysis.<sup>412</sup> We could contemplate new interpretations of existing contract doctrines, like good faith<sup>413</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>414</sup> Or, more radically, we could consider, as some have suggested, getting rid of mutual assent entirely.<sup>415</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>416</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>417</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>418</sup> Perhaps contract law has a role to play in 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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<sup>411</sup> See Singer, Standards, supra note 143, at 142 (suggesting a veil of ignorance analysis).

<sup>412</sup> See Barnhizer, Inequality, supra note 23, at 223-34 (suggesting a bargaining power analysis); Miller, supra note 59, at 531-35 (suggesting a sophisticated party analysis).

<sup>413</sup> 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); Houh, supra note 109 (advocating for use by courts of the doctrine of good faith as a device to eliminate racial subordination).

<sup>414</sup> 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.)

<sup>415</sup> 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).

<sup>416</sup> Joseph W. Singer, Normative Methods for Lawyers, 56 UCLA L. Rev. 899 (2009).

<sup>417</sup> See supra Parts III. and IV. See also, Daniel D. Barnhizer, "Bargaining Power as Contract Theory," in Visions of Contract Theory at 147 (2007)(noting that, [b]ecause power is so complex and dynamic . . . bargaining power subdoctrines will always be subject to criticism of incoherency and indeterminacy.")

<sup>418</sup> Singer, Normative, supra note 416, at (abstract).