

## A REEXAMINATION OF NONSUBSTANTIVE UNCONSCIONABILITY

*Alan Schwartz* \*

THE doctrine of unconscionability, which a court may invoke to invalidate a contract, has a nonsubstantive and a substantive branch. Nonsubstantive unconscionability arises when certain factors, such as a lack of commercial sophistication, apparently prevent a contracting party from exercising his freedom to choose the terms of an agreement.<sup>1</sup> Substantive unconscionability arises when a contract yields a result that affects a contracting party too harshly or that affects a noncontracting party adversely. Such contracts may include an agreement containing a disclaimer of warranties<sup>2</sup> or an assignment of wages.<sup>3</sup> These two branches of un-

---

\* Professor of Law, University of Southern California Law Center. Earlier versions of this paper were presented before the Commercial, Contract and Related Consumer Law Section of the Association of American Law Schools, December 1976, and a Faculty Workshop at the University of Southern California Law Center. Michael Graetz, Michael E. Levine, Stephen J. Morse, Charles J. Goetz, Julius G. Getman and Joseph F. Brodley made particularly useful comments on prior drafts, and David Grether, of the California Institute of Technology, also made thoughtful suggestions. The responsibility for any errors that remain is mine.

<sup>1</sup> See *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 467-68, 150 P.2d 436, 443-44 (1944) (Traynor, J., concurring); *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J., 358, 161 A.2d 69 (1960).

<sup>2</sup> See U.C.C. § 2-719 (3). A frequently cited rationale for not enforcing a warranty disclaimer is to spread the loss among many consumers rather than to impose the entire loss upon one unfortunate consumer. See, e.g., *Escola v. Coca Cola Bottling Co.*, 24 Cal. 2d 453, 462, 150 P.2d 436, 441 (1944) (Traynor, J., concurring).

<sup>3</sup> An assignment of wages may adversely affect the assignor's family or his creditors other than the assignee. In an early case declaring unconstitutional a statute permitting wage assignments, a Pennsylvania court noted:

[F]reedom of contract is a great and necessary right, but it has its limit. And this limit is reached and passed when a man's future labor is pledged to pay his past debts, with the consequence that he and his family are rendered liable to fall from the status of free citizenship into the degradation of pauperism.

*Foster's Application*, 23 Pa. D. 558, 564 (1914). The same policy considerations motivated many legislatures to permit wage assignments only if the debtor and his spouse had signed a written agreement. See Fortas, *Wage Assignments in Chicago-State Street Furniture Co. v. Armour & Co.*, 42 YALE L.J. 526, 553-54 (1933). Most states now prohibit wage assignments. See UNIFORM CONSUMER CREDIT CODE § 3.305. To protect the property available to other creditors, some commentators also have argued against permitting a debtor to assign a security interest in after-acquired property. See, e.g., Countryman, *Code Security*

conscionability hereinafter are labeled "nonsubstantive" factors or objections and "substantive" factors or objections, respectively.<sup>4</sup>

This article explores the nonsubstantive objections to the enforcement of a contract.<sup>5</sup> These objections fall into four categories. The first category, poverty, involves those situations where a poor consumer, although he would prefer not to bear certain risks under a contract, can afford only with great difficulty an agreement that allocates these risks to the seller. The second category, market unresponsiveness, comprises two possible restrictions upon a contracting party's freedom of choice. First, a buyer accepting a standardized agreement may have to take terms that do not reflect his true preferences because the additional cost of particularizing the contract would exceed the additional benefit that he would derive from an individualized agreement. Second, a seller exercising monopoly power may offer a buyer fewer choices than would exist in a competitive market. The third category of nonsubstantive unconscionability, incompetency, addresses the problem of a buyer who may be too unsophisticated or too inept to make contracts that fully satisfy his preferences. The fourth category, lack of information, involves those situations where a contracting party lacks the information to make his preferences and purchases congruent, either because the information is unavailable or because the cost of finding and absorbing it exceeds, at the margin, the value of the information.

This article seeks to demonstrate that the first three categories of nonsubstantive objections described above do not support a decision to invalidate a contract. To the contrary, the factor relating

---

*Interests in Bankruptcy*, 75 COM. L.J. 269 (1970); cf. Countryman, *Improvident Credit Extension: A New Legal Concept Aborning?*, 27 ME. L. REV. 1 (1975) (suggesting that the improvident extension of credit is undesirable partly because it adversely affects the debtor's other creditors).

<sup>4</sup> The nonsubstantive factors are more commonly labeled "procedural" factors. E.g., J. WHITE & R. SUMMERS, *HANDBOOK OF THE LAW UNDER THE UNIFORM COMMERCIAL CODE* 128 (1972). The term "procedural," however, focuses too narrowly upon the negotiating process. This article uses the term "nonsubstantive" rather than "procedural" because the former, unlike the latter, includes factors that may militate against enforcing an agreement even though the parties negotiated the agreement fairly.

<sup>5</sup> Although employing different analytical approaches, several recent articles provide a useful discussion of the same issues explored below. Dawson, *Unconscionable Coercion: The German Version*, 89 HARV. L. REV. 1041 (1976); Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & ECON. 293 (1975); Kornhauser, *Unconscionability in Standard Forms*, 64 CALIF. L. REV. 1151 (1976).

to poverty actually weighs in favor of enforcing an agreement. The remaining factors—standardized contracts, monopoly power, and incompetence—are simply irrelevant to the question of whether or not to enforce a contract. Whether the fourth category—lack of information—or the substantive objections militate in favor of or against enforcing an agreement is beyond the scope of this article.<sup>6</sup>

The prevailing view requires proof of both nonsubstantive and substantive unconscionability to render a contract unenforceable.<sup>7</sup> This article seeks to shorten the list of relevant nonsubstantive objections by demonstrating that poverty, market unresponsiveness, and incompetence are improper reasons to invalidate a contract. Thus, a judicial or legislative decisionmaker invoking the unconscionability doctrine to refuse to enforce an agreement can tenably rely only upon the fourth category of nonsubstantive objections—lack of information—and upon the substantive objections.<sup>8</sup>

---

<sup>6</sup> The issues raised by a consumer's lack of information and by substantive unconscionability are sufficiently complex to warrant independent treatment.

<sup>7</sup> The nonsubstantive or substantive factors standing alone are necessary but not sufficient to invalidate an agreement under the doctrine of unconscionability. That is, "[m]ost courts take a 'balancing approach' to the unconscionability question, and to tip the scales in favor of unconscionability, most courts seem to require a certain quantum of procedural plus a certain quantum of substantive unconscionability." J. WHITE & R. SUMMERS, *supra* note 4, at 128. See also *id.* at 118-19.

<sup>8</sup> The following example illustrates the scope of this article. Assume that a contract for the sale of a refrigerator contains a clause providing that: "The seller will repair or replace any defective parts but, if good faith attempts to repair the refrigerator are unsuccessful, the buyer is without remedy." Consider the following arguments against enforcing the clause:

- (1) the clause is unconscionable because it imposes large losses on consumers forced to pay for useless refrigerators (substantive objection) and because these consumers are poor (nonsubstantive objection).
- (2) the clause is unconscionable because it imposes large losses on consumers (substantive objection) and because these consumers lacked the information necessary to evaluate the risks created by the clause (nonsubstantive objection).
- (3) the clause is unconscionable because it imposes large losses on consumers (substantive objection).

With respect to the first argument, this article concludes that a buyer's poverty actually militates in favor of enforcing an agreement because banning a contract clause yields a nonoptimal result. Therefore, the first argument, which lacks a legitimate nonsubstantive objection, should be insufficient, under current law, to invalidate the contract clause. The article withholds judgment on the second argument because the problems arising when buyers are uninformed seem sufficiently complex to justify independent treatment. Nor does the article address the question raised by the third argument: whether the substantive objections to a contract clause, standing alone, should be sufficient to justify nonenforcement under the doctrine of unconscionability.

The following analysis of each category of nonsubstantive unconscionability assumes that the other categories are absent. For example, the discussion of poverty assumes that markets are responsive, buyers are competent, and buyers have sufficient information. Because lack of information is not considered here, the analysis always assumes that buyers have enough information to make rational market choices. In addition, the article assumes that each nonsubstantive factor has only *independent* importance to the decision of whether to enforce an agreement. If the policy considerations underlying, for example, the poverty and incompetence objections suggest that each of these categories is individually irrelevant to an enforcement decision, this article assumes that these objections, taken together, are also irrelevant. This assumption seems logically justified, because summing objections that are irrelevant to contract enforcement should not produce a relevant composite objection.

### I. POVERTY

A contracting party's poverty is commonly thought to militate in four ways against enforcing an agreement. First, poverty may impede the buyer's efforts to purchase a "fair" contract. The cost of a contract reflects, among other things, the agreement's allocation of risk between buyer and seller. For example, a contract disclaiming product warranties usually is cheaper than a contract providing such warranties.<sup>9</sup> Although an affluent buyer often can pay the premium necessary to induce a seller to assume significant risks under a contract, a poor buyer may experience great difficulty in trying to buy away disfavored terms.

Second, poverty is thought to correlate strongly with a buyer's lack of commercial sophistication. A poor consumer, therefore, is often said to be at a disadvantage relative to more affluent parties in understanding and negotiating contracts. Third, poverty may restrict the flow of commercial information to poor consumers. If sellers provide less information in ghetto markets than in other markets, even a poor consumer skilled in bargaining may be unable to evaluate the terms of a proposed agreement. Fourth, poverty

---

<sup>9</sup> Although the analysis applies equally to other contractual provisions, this article often will refer to warranty disclaimers because the effect of such provisions is easy to understand.

may exacerbate the consequences of certain contract clauses. An acceleration clause, for example, may bear more harshly upon a poor consumer than upon an affluent consumer.

This article, unlike many commentaries<sup>10</sup> and judicial opinions,<sup>11</sup> distinguishes among these four aspects of poverty because each aspect implicates different institutional and policy considerations germane to the question of whether to enforce a contract. The first aspect, poverty as an impediment to a poor consumer's ability to buy away disfavored terms, is discussed in Part I. The second aspect, poverty as a possible limitation upon a consumer's competence, is discussed in Part III. The third and fourth aspects are beyond the scope of this article.<sup>12</sup> Therefore, the terms "poverty" and "poor buyers," as used in Part I, refer to the situation where a contracting party has so little money that he can buy away disfavored terms only with considerable difficulty.

#### A. Prohibiting Particular Contract Clauses

Prohibiting a contract clause because a poor buyer finds it difficult to purchase more favorable terms yields a nonoptimal result. Assume, for example, that a retailer is offering two contracts that are identical except for one clause: the first contract, which costs

---

<sup>10</sup> For example, the recent Property Restatement imposes an "implied warranty of habitability" on landlords and provides that a disclaimer of the implied warranty, if unconscionable, may be unenforceable. RESTATEMENT (SECOND) OF PROPERTY §§ 5.1, 5.6 (1977). A "factor" relevant to a finding of unconscionability is "[w]hether . . . the agreement . . . (especially if it relates to low or moderate income residential property) imposes unreasonable liabilities or burdens on persons who are financially ill-equipped to assume those burdens and who may have had significant inequality of bargaining power . . ." *Id.* § 5.6, Comment e(6). This single "factor" seems to combine all four aspects of poverty: whether an agreement imposes unreasonable burdens on financially ill-equipped persons relates to the fourth aspect; whether an agreement imposes such burdens on persons who lack equal bargaining power implicates the first, second, and third aspects. Other commentators also seem not to make the distinctions drawn here respecting poverty. See Johnson, *The Uniform Consumer Credit Code and the Credit Problems of Low-Income Consumers*, 37 GEO. WASH. L. REV. 1117 (1969); Jordan & Warren, *The Uniform Consumer Credit Code*, 68 COLUM. L. REV. 387 (1968).

<sup>11</sup> *E.g.*, *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

<sup>12</sup> See note 6 *supra* and accompanying text. Whether the fourth aspect of poverty—that certain clauses may operate more harshly on the poor—justifies nonenforcement of a contract clause raises important questions concerning whether courts should engage in redistributing wealth. See Schwartz, *Sales Law and Inflation*, 50 SO. CAL. L. REV. 1 (1976) (arguing that courts deciding sales cases should not attempt to redistribute wealth). These questions, which implicate institutional and policy issues quite different from those raised by the other aspects of poverty, seem best discussed elsewhere.

\$100, includes a warranty against product defects, while the second contract, which costs \$90, includes a disclaimer of the warranty. The hypothetical retailer has customers for both contracts, but the state, by statute or judicial opinion, later bans the warranty disclaimer. Under these circumstances, the prohibition against warranty disclaimers neither helps nor hurts those customers who would have purchased warranty coverage. The prohibition, however, harms the customers who would have purchased a contract disclaiming all warranties. These consumers apparently value the insurance against product defects provided by a warranty less than they value other uses for their \$10. Therefore, the prohibition against disclaimers yields a nonoptimal result: some buyers regard themselves as worse off than before the ban, and no buyers regard themselves as better off.<sup>13</sup>

This result is particularly undesirable because banning warranty disclaimers is likely to affect the poor more adversely than the affluent. A poor person spends a large percentage of his income on goods for which his demand is income-inelastic,<sup>14</sup> *e.g.*, food, shelter, and clothing. As his income rises, he will begin to purchase goods for which his demand is more income-elastic. Analysis indicates that a poor person's demand for warranty protection is probably more income-elastic than that for "necessities." Many of the contract clauses that are now of concern, such as warranty disclaimers, shift purchase risks to buyers. Poor people generally are more risk averse than rich people because they cannot withstand large losses.<sup>15</sup> The poor, however, may lose relatively less than the middle class when purchase risks materialize because, in the circumstances discussed here, the poor have less at stake. For example, middle

---

<sup>13</sup> The measure of optimality employed here is the "Pareto criterion." According to this criterion, an allocation of resources is optimal only if no one may be made better off, in his own estimation, without simultaneously making someone else worse off, and a change in the allocation is optimal only if it makes at least one person better off and no one worse off. *See, e.g.*, J. HENDERSON & R. QUANDT, MICROECONOMIC THEORY: A MATHEMATICAL APPROACH 255 (1971); T. SCITOVSKY, WELFARE AND COMPETITION 58 (rev. ed. 1971). Conversely, a situation is nonoptimal if one or more persons may be made better off without making anyone else worse off. J. HENDERSON & R. QUANDT, *supra*, at 255.

<sup>14</sup> Income elasticity measures the responsiveness of demand for a certain good to changes in income. More specifically, it is defined as the percentage change in quantity divided by the percentage change in income. *E.g.*, T. SCITOVSKY, *supra* note 13, at 44 n.6; G. STIGLER, THE THEORY OF PRICE 33 (3d ed. 1966).

<sup>15</sup> H. RAIFFA, DECISION ANALYSIS: INTRODUCTORY LECTURES ON CHOICE UNDER UNCERTAINTY 91-94 (1970).

class buyers who default may lose valuable property, while poor buyers have much less property to lose. Also, accidents may cause middle class buyers to lose wages, while poor buyers on welfare may lose no income at all. Because a poor person, thus, is probably more anxious than a rich person to forego the insurance a warranty affords, prohibiting warranty disclaimers or other contract clauses will bear more harshly upon the poor than upon the affluent. Therefore, a contracting party's poverty, other things being equal, should militate in favor of, rather than against, enforcing a contract clause.<sup>16</sup>

If increased risk-bearing produces economies of scale, however, the prohibition against a warranty disclaimer does not necessarily yield a nonoptimal result. The prohibition would increase the sale of contracts containing a warranty against product defects. Assume, for example, that economies of scale cause a reduction in the cost of warranty coverage from \$10 to \$5. The prohibition would then benefit buyers who would pay \$5 or more for warranty protection but would harm buyers who would not pay at least \$5 for such protection. In theory, then, the new legal rule barring warranty disclaimers could yield an optimal result regardless of whether the rule is analyzed in terms of "Pareto optimality" (that is, where the winners from a legal change actually compensate the losers and remain better off in their own estimation) or in terms of the "Scitovsky criterion" (that is, where, absent transaction costs, the winners could compensate the losers, and the losers could not bribe the winners to oppose the change).<sup>17</sup> Moreover, even if

---

<sup>16</sup> A recent study of food stamp recipients provides empirical verification of the argument that restrictions upon the choices facing consumers yield inefficient results. The study estimated that, on the average, food stamp recipients value a food stamp enabling them to purchase \$1.00 of food at \$ .82. K. CLARKSON, *FOOD STAMPS AND NUTRITION* 42 (1975). The recipients would obviously value \$1.00 of cash at \$1.00. It is also reported that recipients (illegally) sell \$1.00 food stamp coupons to grocery stores for approximately \$ .75. Giertz & Sullivan, *Donor Optimization and the Food Stamp Program*, 29 *PUB. CHOICE* 19, 23 n.5 (1977). Requiring a buyer to spend \$10.00 on a warranty similarly is unlikely to yield him \$10.00 of utility.

The FTC, however, recently proposed regulations that limit the ability of consumers to give security for debts or otherwise to agree to proposed creditor remedies. 40 *Fed. Reg.* 16,347 (1975) (to be codified, if promulgated, in 16 *C.F.R.* pt. 444). These restrictions were proposed in large part because "consumers receive no substantial benefit in exchange for" the contract clauses. *Id.* at 16,348. Although not arguing against adoption of these rules, this article does claim that the cited reason for the rules is erroneous.

<sup>17</sup> J. HENDERSON & R. QUANDT, *supra* note 13, at 279. The "Scitovsky criterion" is preferable to the "Kaldor criterion." The latter, which only asks whether the winners

neither optimality criterion suggests that the new legal rule is optimal, the rule nevertheless could be distributionally desirable, because society might prefer to make the winners better off from the legal change at the losers' expense.

Although an optimal or distributionally desirable result theoretically is possible, a prohibition against warranty disclaimers would be unlikely for two reasons to yield such a result in practice. First, the increased sales of product warranties probably would not create significant economies of scale. Economists generally assume constant returns to scale over most ranges of output;<sup>18</sup> that is, an increase in inputs is assumed to yield a proportional increase in output. Economies of scale arise when lower average costs are associated with larger output.<sup>19</sup> A warranty against defects is a labor intensive product, requiring labor to process complaints and to perform repairs. Because the potential gains from cooperation and specialization in the performance of such activities seem small, the seller of a warranty would be unlikely to experience significant reductions in average cost when he increased output.<sup>20</sup> If so, the seller's economies of scale would be small. Consistent with this analysis, labor intensive businesses, such as repair shops and service stations, often are small enterprises, and studies indicate that the installment loan business, which is also labor intensive, has approximately constant returns to scale.<sup>21</sup>

---

could compensate the losers, sometimes yields inconsistent results, because the criterion may indicate that a legal change is optimal even though the losers could bribe the winners to oppose the change. R. MEYER, *MICROECONOMIC DECISIONS* 360-61 (1976); A. SEN, *COLLECTIVE CHOICE AND SOCIAL WELFARE* 31 (1970).

<sup>18</sup> E.g., G. STIGLER, *supra* note 14, at 151. For empirical evidence corroborating this assumption, see Douglas, *The Cobb-Douglas Production Function: Its History, Its Testing, and Some New Empirical Values*, 84 J. POL. ECON. 903 (1976).

<sup>19</sup> E.g., J. HIRSCHLEIFER, *PRICE THEORY AND APPLICATIONS* 259 (1976).

<sup>20</sup> The factors that yield economies of scale include unused capacity, economies of large scale purchases, specialized processes of production, and economies of large scale plant operation. See G. STIGLER, *supra* note 14, at 153-54; Cox, *Consumer Information and Competition in the Synthetic Detergent Industry*, 15 NEB. J. ECON. & BUS. 41 (1976). These factors seldom arise in the business of selling and servicing product warranties.

<sup>21</sup> See Johnson, *The New Law of Finance Charges: Disclosure, Freedom of Entry, and Rate Ceilings*, 33 LAW & CONTEMP. PROB. 671, 681-82 (1968). Slight economies of scale sometimes may exist. For example, a firm that services a large number of warranties and that maintains a large inventory of replacement parts may achieve economies of scale when purchasing its inventory. Also, a firm that requires its workers to specialize in the handling of particular complaints may obtain economies stemming from the specialization of labor. Such economies of scale, however, would seldom be significant because the business of selling and servicing warranties is primarily labor intensive.



Second, even if important economies of scale do exist, sellers are likely to have tapped these opportunities without state intervention. When such economies exist, a seller typically will increase his output to obtain the higher profits made possible by the reduction in the average cost of producing each unit of output. Therefore, a seller would exploit existing economies of scale even absent a legal rule prohibiting warranty disclaimers.

The foregoing analysis ignores the possibility that, if the preferences of nonpurchasers of warranties were considered, a prohibition against warranty disclaimers might yield an optimal or distributionally desirable result. Assume that *X*, a wealthy individual, derives satisfaction (or, as economists say, "utility") from the knowledge that poor people make "wise" purchases. Because *X* believes that buying warranties is "wise," his utility rises when the prohibition against disclaimers forces buyers to purchase warranties. Under these circumstances, the conclusion that prohibiting disclaimers makes no one better off is false: the prohibition, though not benefitting any buyers, does benefit the *X*'s.<sup>22</sup> If the *X*'s could compensate the disadvantaged buyers and remain better off than before the change, and if the buyers could not bribe the *X*'s to oppose the change, then the prohibition would yield an optimal result. However, if the result of these hypothetical transactions were impossible to calculate, the question of whether the ban is

---

<sup>22</sup> This analysis of *X*'s preferences assumes that utility functions are interdependent. That is, the analysis assumes that persons derive utility not only from their own income and nonmarket activities, but also from particular, approved activities of other people. In this context, *X* derives utility from the knowledge that the poor are buying warranties, a practice of which *X* approves.

Some commentators point to the existence of interdependent utility functions to support the argument that resources can be redistributed in an optimal manner. They argue that, because the donors also derive satisfaction from increases in the donees' utility, a redistribution of resources can increase the welfare of some persons without decreasing the welfare of others. See Daly & Giertz, *Transfers and Pareto Optimality*, 5 J. PUB. ECON. 179 (1976); Hochman & Rogers, *Redistribution & the Pareto Criterion*, 64 AM. ECON. REV. 752 (1974); Hochman & Rogers, *Pareto Optimal Redistribution*, 59 AM. ECON. REV. 542 (1969). Relying upon interdependent utility functions to justify restrictions upon individual choice, however, is troublesome for two reasons. First, if the majority legitimately may regulate a minority because the latter's choices affect the former's utility, the danger exists that the majority could restrain unduly the minority's freedom and privacy. See A. SEN, *supra* note 17, at 82-83. Second, as will be developed below, the calculation required to aggregate the preferences of warranty purchasers and nonpurchasers is an almost impossible task. Thus, arguments resting on the existence of interdependent utility functions tend to be inconclusive.

desirable would turn on whether society preferred to make the *X*'s better off at the expense of the disadvantaged buyers.

Including the preferences of both warranty purchasers and non-purchasers in the optimality calculus, however, does not alter the conclusion that prohibiting warranty disclaimers or other contract clauses is undesirable. The optimality calculus must sum not only the effect of the prohibition on the utilities of *X*'s (positive) and of buyers (negative), but also the effect on the utilities of those *Y*'s (negative) who derive satisfaction from knowing that the poor are free to contract. No theory predicts the outcome of this calculation, and the empirical evidence that might support it is simply too expensive to collect. Even so, if one is to speculate, a prohibition against disclaimers could not be optimal unless the *X*'s knew that the prohibition existed, and popular awareness of particular restrictions on the ability to contract seems limited. Therefore, even when the preferences of nonpurchasers are considered, a prohibition against disclaimers seems unlikely to yield an optimal result.

Even if this optimality calculus is thought to yield an inconclusive result, a prohibition against disclaimers is difficult to justify on distributional grounds. An initial weakness in such a position is the fact that the individuals who supposedly benefit from knowing that the poor are making "wise" purchases must, in fact, know that the prohibition exists. But, as noted above, the level of popular awareness regarding restrictions on freedom to contract is low. A more serious objection is that the prohibition, which sacrifices the welfare of the poor to satisfy the preferences of the more affluent, has an undesirable distributional effect. Prohibiting warranty disclaimers or other contract clauses because the affluent would derive more utility from banning such clauses than the poor would gain from permitting them runs counter to prevailing redistributive rationales.

In sum, when a contract clause is prohibited because a poor buyer finds it difficult to purchase a more favorable provision, the court or legislature prohibiting the clause produces a nonoptimal result. The prohibition creates a situation in which some buyers regard themselves as worse off than before the ban and no buyers regard themselves as better off. Even when the welfare of nonpurchasers is considered, the utility calculus suggests that prohibiting a contract clause will yield a nonoptimal outcome. That outcome, moreover, is distributionally objectionable. Thus, a buyer's pov-

erty militates in favor of, rather than against, enforcing an agreement.<sup>23</sup>

### *B. Compensatory Grants or Subsidies*

To correct the nonoptimal result of a ban on warranty disclaimers, a legislature that enacted the prohibition might seek to compensate poor buyers for their welfare losses. By compensating the poor, the legislature could overcome some of the problems, discussed above, that arise when a warranty disclaimer is prohibited. For example, if the government provided compensatory grants, the fact that aggregating the preferences of warranty purchasers and nonpurchasers is almost impossible would be a less serious obstacle because the poor suffer no harm when they are compensated and the affluent would not benefit at the expense of the poor. This solution, however, seems unworkable because the proper amount of compensation is simply too difficult to determine. Not only is it generally impractical to measure welfare losses resulting from a legal change, but poor buyers would have a strong incentive to engage in strategic behavior by claiming nonexistent injury or by overstating the extent of actual injury. Because welfare losses are subjective and difficult to quantify, the state seldom could demonstrate that a claimant had exaggerated his loss. Thus, a compensation system is not a tenable solution to the nonoptimality problem.

Subsidizing particular contract clauses is an apparently more promising legislative solution. For example, if a seller would charge \$10 to delete a disclaimer, the legislature could subsidize him to reduce the price to \$3. More buyers then might purchase the warranty. If such a subsidy is provided, however, a court should not intervene to prohibit the warranty disclaimer. A judicial prohibition against the disclaimer would contravene the statutory purpose underlying the subsidy, which is to increase seller risk-bearing by influencing buyer choice, not by eliminating it. In addition, such a prohibition, for reasons outlined above, is unlikely to yield an optimal result.<sup>24</sup>

---

<sup>23</sup> A court or legislature, of course, tenably can invalidate an agreement due to substantive or informational considerations that outweigh the fact that a buyer is poor.

<sup>24</sup> A legislature that attempted to subsidize the production of warranties also would confront problems involving the subsidy's effectiveness and feasibility. The effectiveness problem relates to price inelasticity. If the demand for a subsidized good or service were

## II. MARKET UNRESPONSIVENESS<sup>25</sup>

### A. Failure to Particularize Contracts<sup>26</sup>

In mass markets, sales contracts do not reflect the individual preferences of every buyer, because of the high cost of particular-

---

price inelastic, the desired impact of a subsidy, which is to boost the sale of the subsidized item, would occur only slightly, because consumers would not increase significantly their consumption of the subsidized good or service. Rather than buying much more of the subsidized item as its price fell, the consumers would purchase approximately the same amount, using for other purposes the savings that the price reduction made available. See generally C. SHOUP, PUBLIC FINANCE 158-61 (1969). The relevant "service" here is "seller risk-bearing for a price," which probably is price inelastic because it has few close substitutes.

The administrative problem is the difficult task of pricing a subsidy. The cost of a subsidy has two components: the cost of honoring the warranty discounted by the likelihood that the item will fail, and the residual cost borne by the consumer. Because the failure rate for different products varies, because the effect of a product failure on different people varies, and because the cost of honoring different warranties varies, a legislature seeking to price a subsidy would confront a difficult administrative problem.

<sup>25</sup> Courts sometimes treat temporary imbalances between supply and demand as an aspect of nonsubstantive unconscionability. For example, some courts have invalidated exculpatory clauses in leases partly because the clauses were procured during housing shortages. See *Kay v. Cain*, 154 F.2d 305 (D.C. Cir. 1946) (dicta); *Kuzmiak v. Brookchester, Inc.*, 33 N.J. Super. 575, 111 A.2d 425 (1955). *Contra O'Callaghan v. Waller & Beckwith Realty Co.*, 15 Ill. 2d 436, 155 N.E.2d 545 (1958) (though decided over a strong dissent). Such restrictions upon freedom to contract, however, are an inappropriate response to the problem of shortrun discontinuities between supply and demand. Preventing sellers from raising their price (or otherwise shifting costs to buyers) in response to increased demand will reduce their incentive to expand output to satisfy the increased demand. Alternatively, it will induce them to shift costs to buyers in ways that the law permits (*i.e.*, a decline in some services if exculpatory clauses are banned) but that buyers do not prefer to the actions the law condemns. Both seller responses (underproduction or avoidance of regulation) cause deadweight efficiency losses. It is, moreover, unclear whether the distributional gains from regulating contracts outweigh these losses, because it is difficult to establish and evaluate the incidence of those gains. Cf. Graetz, *Assessing the Distributional Effects of Income Tax Revision: Some Lessons From Incidence Analysis*, 4 J. LEG. STUD. 351 (1975) (discussing the direct and indirect impact of tax burdens). For example, while some tenants may be benefitted by the striking of exculpatory clauses, other tenants will be hurt if the ban contributes to restricting the number of rental properties or making existing properties less desirable. When judicial intervention could cause sure efficiency losses for uncertain distributional gains, and when the economic phenomena are temporary and largely self-correcting, the courts should not interfere with the market mechanism. Thus, temporary imbalances between supply and demand should not militate against enforcing contracts.

<sup>26</sup> In this section, the term "standardized contract" refers to a form agreement in which the seller offers a buyer neither a choice of terms nor a choice among a variety of form agreements. Unless otherwise indicated, see note 30 *infra*, the term "particularized contract" refers to the situation where a buyer either may obtain an agreement custom-tailored to his individual preferences or may select among a wide variety of form agreements.

izing such agreements. The costs incurred when a seller drafts and administers a particularized agreement often exceed the additional benefit a buyer would derive from such an agreement. As a result, sellers often cannot offer particularized contracts at prices that even affluent consumers would pay. Thus, all buyers sometimes must accept contractual provisions that they, in some sense, do not want.

The failure of sellers to particularize contracts is a frequently invoked aspect of nonsubstantive unconscionability. Two arguments seem to underlie judicial hostility towards standardized agreements.<sup>27</sup> The first argument presupposes that sellers mistakenly tend to ignore the preferences of buyers. More specifically, sellers are sometimes thought not to realize that enough consumers prefer particular contract clauses to enable these clauses to be offered at reasonable prices. If a consumer were to request such a provision, a seller therefore would charge "too much" for it or not offer it at all. Making a seller's failure to particularize contracts militate against enforcement responds to this problem by raising the cost of a seller's mistakes. A seller who offers the "wrong" mix of contract clauses thereby faces a reduced likelihood that a court will enforce his agreements. Because nonenforcement is costly, sellers are likely to respond by investing more resources in ascertaining consumer preferences accurately.

The second argument underlying judicial hostility towards standardized agreements assumes that each consumer has a right to affect his own contracts—that is, consumers have a right to contractual self-determination. This assumption, in turn, rests on the premise that expanding a person's "opportunity set" (his range of choices) is socially desirable. According to this view, society and individual consumers will benefit if consumers have a large array of contract clauses from which to choose. Making a seller's failure to particularize militate against enforcement responds to the desire

---

<sup>27</sup> See note 26 *supra*. The two arguments discussed below, which seldom are delineated explicitly, resemble Professor Clark's "reasons" for regulation: "By 'reasons' I do not mean causal or historical explanations . . . ; instead, I mean considerations that justify regulation." Clark, *The Soundness of Financial Intermediaries*, 86 YALE L.J. 1, 10 (1976). A third argument against enforcing a standardized agreement is that even a competent consumer may be unaware of the contents of such an agreement. See generally Davis, *Protecting Consumers from Overdisclosure and Gobbledygook: An Empirical Look at the Simplification of Consumer-Credit Contracts*, 63 VA. L. REV. 841 (1977) This problem, which relates to a consumer's lack of information, is beyond the scope of this article.

to expand consumer opportunity sets by raising the cost to a seller of ignoring the preferences of individual buyers. A seller who ignores such preferences thereby faces a reduced likelihood that a court will enforce his agreements. If the cost of nonenforcement is greater than the cost of increased particularization, sellers will then offer a wider variety of contract clauses.

Neither of these arguments justifies a legal rule under which a seller's failure to particularize contracts militates against enforcement. The first argument implicitly and erroneously presupposes that courts are more likely than sellers to gauge consumer preferences accurately. The second argument is unpersuasive on two grounds: it fails to balance properly the right to contractual self-determination against the efficiency losses stemming from increased contractual particularization, and its assumption that nonenforcement often will increase contract variety is probably incorrect.

### *1. Judicial Review of Business Judgments Respecting Consumer Preferences*

The first argument for restricting the enforceability of standardized agreements—that sellers mistakenly fail to satisfy buyer preferences—rests upon the premise that a court should decide whether a seller accurately gauged consumer preferences. This premise, however, ignores the fact that a seller has a large advantage over a court in accurately ascertaining those preferences. A seller has greater expertise in commercial matters, better facilities for ascertaining consumer preferences, and greater incentive to know them accurately.<sup>28</sup> In light of these institutional considerations, a court should not review business decisions respecting whether buyers in the aggregate did or did not prefer particular

---

<sup>28</sup> The assertion that sellers have an advantage over courts in accurately ascertaining buyer preferences does not imply that sellers always correctly satisfy those preferences. For example, the cost to a seller of making a warranty is partly a function of the care the buyer exercises in using the product. In a market where many buyers are apt to be careless, a seller may make fewer warranties than the amount dictated by consumer demand, because it is too expensive to distinguish between careful and careless buyers. Cf. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. ECON. 488 (1970) (observing that because people demand insurance in proportion to their expected need to file claims and because the percentage of insured parties who actually will file claims rises as the price of insurance rises, there may be situations in which insurers are unwilling to offer insurance coverage at acceptable prices). Thus, the assertion regarding the seller's advantage implies only that sellers are more likely than courts to ascertain consumer preferences accurately.

clauses. And, if a court should refrain from such a review, the first argument, which presupposes that courts ought to decide whether sellers have mistakenly ignored consumer preferences, must be rejected.<sup>29</sup>

## 2. *Efficiency Losses Versus the Expansion of Individual Choice*<sup>30</sup>

The second argument against standardized agreements seeks to vindicate a buyer's right to contractual self-determination by restricting the enforceability of such agreements. An initial objection to this argument is that a restriction on the enforceability of standardized contracts would create an efficiency loss.<sup>31</sup> This objection rests on two assumptions. First, to make the objection nontrivial, it assumes that the cost to a seller of the diminished enforceability of his standardized agreements exceeds the cost of drafting and administering several new contracts. Thus, the reduced likelihood of enforcing a standardized agreement would cause a seller to offer a greater variety of contracts. Second, the objection assumes that sellers do not overlook profitable activities—that is, sellers do not mistakenly ignore buyer preferences.<sup>32</sup>

The efficiency loss would result from a reduction of output, which would occur because the creation of several new contracts will increase a seller's fixed and variable costs. The fixed costs of producing a new contract will include lawyer's fees for drafting the agreement, printer's fees for start-up tasks in printing the agreement, and training costs for acquainting sales personnel with the new provisions. The increase in variable costs will relate to sales

---

<sup>29</sup> Sellers also have a comparative advantage over legislatures and administrative agencies in accurately ascertaining consumer preferences, for the reasons given above. Thus, the foregoing argument also applies when these institutions seek to increase the satisfaction of consumer preferences by banning or requiring particular contract clauses.

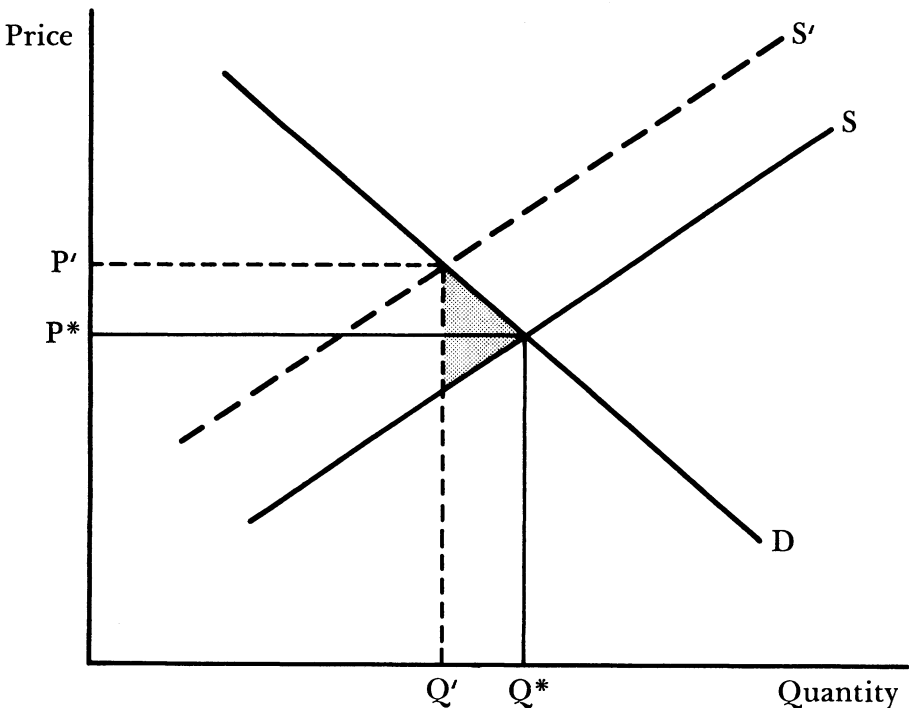
<sup>30</sup> See note 26 *supra*. In this subsection, the analysis refers to a seller particularizing an agreement by offering a variety of form agreements. The analysis, however, is equally applicable to the situation where a seller particularizes an agreement by offering contracts custom-tailored to the preferences of individual consumers.

<sup>31</sup> This article, unlike previous discussions of the efficiency aspects of standardized contracts, see, e.g., Slawson, *Standard Form Contracts and Democratic Control of Lawmaking Power*, 84 HARV. L. REV. 529 (1971); Llewellyn, Book Review, 52 HARV. L. REV. 700 (1939), argues that these efficiency considerations strongly support the enforcement of standardized contracts.

<sup>32</sup> Assuming that sellers do not overlook profitable alternatives seems, subject to the considerations discussed above, see note 28 *supra*, more plausible than assuming the contrary.

and administrative costs. First, to the extent that a seller offers a greater variety of contracts, the cost of negotiating the sale of a contract will increase because the transaction becomes more complex. Second, many contracts may involve continuing administrative obligations, such as repairing and replacing defective parts of the product sold. To the extent that a seller administers a greater variety of contracts, the cost of administering each agreement will rise because the seller simultaneously must comply with several sets of contractual obligations. The increase in fixed and variable costs will cause a seller's average costs to rise. Because all sellers will be subject to the legal rule, all of them will experience higher average costs. Therefore, the longrun supply curve for the industry would shift upward, and total output would decrease.

The resulting reduction in output is perhaps better demonstrated graphically. The following figure represents the longrun supply ( $S$ ) and demand ( $D$ ) curves for an industry:





Because the longrun supply curve for an industry is the locus of minimum points on the average cost curve for each firm in the industry, and because the creation of several new contracts will increase average costs, a legal rule that induced sellers to offer a greater variety of contracts would shift the longrun curve upward. The shift in the supply curve from  $S$  to  $S'$  would cause physical output to decline from  $Q^*$  to  $Q'$  and price to increase from  $P^*$  to  $P'$ .<sup>33</sup> These changes would create a deadweight efficiency loss of consumers' and producers' surplus (the shaded triangle in the figure above), for without the legal rule additional sales of the physical product would be made at prices buyers would be willing to pay.

The desirability of a legal rule that would induce sellers to offer a greater variety of contracts therefore depends upon whether the benefit of increased buyer choice exceeds the cost of the deadweight efficiency loss that the rule would create. This question is difficult to answer as an abstract inquiry. But resolving the question directly is unnecessary, because society has chosen efficiency over opportunity in an analogous context. An individual consumer rarely can influence the content of products: the market seldom responds to the idiosyncratic preferences of individual buyers. Thus, seven-cylinder cars or four-door refrigerators are not produced. The dissatisfaction of individual consumers or small consumer groups, however, seldom results in state intervention. Our society ordinarily is satisfied if aggregate consumer preferences influence the content of products because the costs of requiring sellers to satisfy idiosyncratic preferences seem to outweigh the benefit of giving people more control over the products they consume.

---

<sup>33</sup> The argument assumes that any possible increase in consumer demand would not generate additional revenue sufficient to offset the increase in cost. This assumption ensures that the demand curve ( $D$ ) will intersect the new supply curve ( $S'$ ) at a point corresponding to a reduction in output. It may be thought that, contrary to this assumption, demand would increase enough to offset the increase in cost, because sellers would be offering a more attractive package—the physical product plus a greater variety of contract terms. This possibility, however, is foreclosed by the second assumption outlined above, *see* note 32 *supra* and accompanying text, which provides that sellers do not mistakenly ignore buyer preferences. According to that assumption, if increased demand would offset increased costs, then sellers already would have exploited such an opportunity for increased profits. Thus, even though consumer demand may increase, such an increase will not offset the increased cost of offering a greater variety of contracts.

If declining average costs to contract innovation exist, however, sellers, absent legal stimulus, would underproduce contract variety. But it seems unlikely that declining average costs obtain for an industry at large. The cost of creating and administering more

In the context of contractual provisions, the costs of requiring sellers to satisfy the preferences of individuals or small groups also seem high, while the gains from expanding the opportunity sets of consumers seem no greater, in the qualitative sense, than the gains in the product context. Until the product analogy is persuasively distinguished, society must be presumed to prefer efficiency over opportunity in the context of contractual provisions. Therefore, the failure to particularize a contract militates in favor of, rather than against, enforcing the standardized agreement.

The foregoing analysis, of course, assumed that a legal rule restricting the enforceability of standardized contracts would induce a seller to offer a greater variety of contracts. Although an increase in the variety of contracts theoretically is possible,<sup>34</sup> a legal rule restricting the enforceability of standardized agreements would be unlikely to yield this result in practice. Under such a legal rule, the cost to a seller of offering a single standardized contract is the reduced likelihood that he can enforce the contract. But the cost of bearing this risk probably is small, because the law of unconscionability renders a contract unenforceable only when a buyer raises both a valid nonsubstantive objection (*e.g.*, the seller's failure to particularize the contract) and a valid substantive objection (*e.g.*, too harsh a bargain). By contrast, the cost to a seller of offering a variety of contracts is significant and immediate. Thus, sellers probably would rather bear the risk of nonenforceability than create more contracts. The intuitively plausible contention that the cost of creating new contracts would exceed the cost of not doing so is supported, albeit impressionistically, by the continued widespread use of standardized contracts notwithstanding the long-standing judicial hostility toward such agreements.<sup>35</sup> Therefore, a legal rule restricting the enforceability of standardized agreements

---

contracts increases in relation to the number of contracts sold. Put another way, creating more contracts increases the demand on the factors of "contract production" (*e.g.*, lawyers, printers, secretaries, and employees to administer contracts). Thus, it is unlikely that sellers will underproduce contract variety.

<sup>34</sup> See text following note 27 *supra*.

<sup>35</sup> In a survey of landlord-tenant cases decided over a two-year period, Professor Berger discovered that residential landlords continued to use form leases even though they had lost over sixty per cent of the cases involving the standardized agreements. Berger, *Hard Leases Make Bad Law*, 74 COLUM. L. REV. 791, 791-92 (1974). See also Kirby, *Contract Law and the Form Lease: Can Contract Law Provide the Answer?*, 71 Nw. U.L. REV. 204 (1976). Similarly, sellers continue to use warranty disclaimers in sales contracts even though courts invalidate an overwhelming percentage of such provisions. See Schwartz, *The Private Law Treatment of Defective Products in Sales Situations*, 49 IND. L.J. 8 (1973).

ultimately may be pointless, because such a rule is unlikely to expand consumer opportunity sets.

In sum, neither argument against standardized agreements supports a decision to invalidate a contract. First, the fact that a seller might mistakenly fail to satisfy buyer preferences is no ground for judicial intervention because a court is ill-suited to second-guess business judgments regarding buyer preferences. Second, if enforcing a buyer's right to contractual self-determination induces a seller to particularize his agreements, the increased particularization of contracts apparently would create an efficiency loss that outweighs the societal benefit derived from enforcing the buyer's right. If, as seems likely, enforcing the right to contractual self-determination fails to induce a significant increase in the particularization of contracts, then this argument against enforcing standardized agreements simply is misplaced. Therefore, a seller's failure to particularize his contracts should not militate against enforcing them.<sup>36</sup>

### B. Market Power

Courts and commentators have suggested that a seller's ability to exercise market power should militate against the enforcement of an agreement. This suggestion apparently rests on the premise, which empirical evidence fails to confirm, that a monopolist or an oligopolist is less responsive than a competitive seller to consumer preferences regarding the content of contracts. This section, however, demonstrates the existence of plausible conditions under which market power is unrelated to the satisfaction of consumer wants. Although resting on untested behavioral assumptions, this demonstration, when considered together with empirical evidence contradicting the conventional wisdom, strongly suggests that resources devoted to proving the existence of market power would be wasted. Therefore, courts should not recognize market power as an aspect of nonsubstantive unconscionability.

In the landmark case of *Henningsen v. Bloomfield Motors, Inc.*,<sup>37</sup> the court, refusing to enforce the disclaimer in the standard auto-

---

<sup>36</sup> This conclusion does not imply that courts should enforce all standardized contracts. A court could legitimately find that the substantive objections to a term outweigh the costs of nonenforcement. The argument, instead, is only that the fact that a contract is standardized should not militate against enforcing it.

<sup>37</sup> 32 N.J. 358, 161 A.2d 69 (1960).

mobile warranty, set forth a classic statement of the view that market power should militate against enforcing an agreement:

The gross inequality of bargaining position occupied by the consumer in the automobile industry is thus apparent. There is no competition among the car makers in the area of the express warranty. Where can the buyer go to negotiate for better protection? Such control and limitation of his remedies are inimical to the public welfare and, at the very least, call for great care by the courts to avoid injustice through application of strict common-law principles of freedom of contract.<sup>38</sup>

The *Henningsen* court implied that sellers exercising market power tend to ignore buyer preferences respecting contractual terms. But this view is intuitively implausible. If a monopolist's customers prefer to have warranties rather than disclaimers, and if these customers will pay the premium for additional warranty protection, the monopolist would be irrational not to offer a warranty. Offering only a disclaimer would cost him potential profits.

A more plausible version of the *Henningsen* claim is that a monopolist or an oligopolist tends to be less responsive than a competitive seller to consumer preferences.<sup>39</sup> If so, a monopolist, for example, would make fewer or narrower warranties than a competitive seller. Even as reformulated, however, the argument is suspect because of an absence of empirical support. In fact, some empirical evidence seems to support the opposite conclusion. Automobile warranties, made by sellers thought to have substantial market power, seem qualitatively and quantitatively similar to

---

<sup>38</sup> *Id.* at 391, 161 A.2d at 87.

<sup>39</sup> One ground for this belief is that the lack of competition in a monopolistic market diminishes the incentive for the firm to satisfy consumer wants. The incentive, however, appears to run in the opposite direction: a monopolist will have a greater incentive than a competitor to satisfy consumer preferences (with the exception of charging below the monopoly price), because a monopolist, unlike a competitor, can capture all of the gains that satisfying additional consumer preferences would create. Schwartz, *Seller Unequal Bargaining Power and the Judicial Process*, 49 *IND. L.J.* 367, 380-81 (1974).

Another ground for this belief is that sellers need particular customers much less than customers need sellers. Thus, sellers have relatively greater bargaining power. See Wilson, *Freedom of Contract and Adhesion Contracts*, 14 *INT'L. & COMP. L.Q.* 172 (1965); cf. *Shell Oil Co. v. Marinello*, 63 N.J. 402, 307 A.2d 598 (1973) (suggesting that franchisees need franchisors more than franchisors need franchisees). But, because customers in competitive markets apparently can find other sellers, the argument implicitly presumes that too few sellers exist. As such, it reduces to a claim, discussed below, that monopoly should militate against enforcement.

warranties issued in more competitive markets.<sup>40</sup> Neither the content of warranties nor the content of other contract clauses has been shown to vary with market structure.

Consistent with the empirical evidence contradicting the second *Henningsen* rationale, a theoretical argument, outlined below, indicates plausible conditions under which market structure does not affect the extent to which a buyer's preferences for contract content are satisfied. The argument assumes that, *ceteris paribus*, the extent to which a buyer's preferences are satisfied varies with the quality of whatever he purchases. Contracts, like products, can be ranked by quality: a "high quality" contract has more characteristics that a consumer prefers (*e.g.*, a comprehensive warranty) or less that he dislikes (*e.g.*, an acceleration clause) than a "low quality" contract. The argument made below demonstrates that contract "quality" is not a function of market structure. Although developed, for the sake of convenience, with reference to a consumer product, the argument is equally applicable to a contract, because contracts also vary in quality.

The argument that product quality is unrelated to market structure rests on three assumptions. First, it assumes that consumer demand for quality does not vary with the amount of physical product consumed. Second, the argument assumes that all firms within a competitive industry use the same technology regardless of the level of industrywide output.<sup>41</sup> Third, it assumes that the production function for a monopolist is "similar" to that of a competitive industry in the sense that the monopolist and competitive industry face the same cost-minimizing factor combinations at any level of output.<sup>42</sup> The second and third assumptions, taken together, assure that considerations of cost-minimization will lead

---

<sup>40</sup> Compare Whitford, *Law and the Consumer Transaction: A Case Study of the Automobile Warranty*, 1968 WIS. L. REV. 1006, with Bogert & Fink, *Business Practices Regarding Warranties in the Sale of Goods*, 25 ILL. L. REV. 400 (1930). See also C. GILLAM, PRODUCTS LIABILITY IN THE AUTOMOBILE INDUSTRY: A STUDY IN STRICT LIABILITY AND SOCIAL CONTROL 189-91 (1960).

<sup>41</sup> This assumption reflects the common situation wherein an industry, not subject to external economies or diseconomies of industry scale, uses inputs whose relative scarcities are unaffected by fluctuations in the level of industrywide output.

<sup>42</sup> This assumption does not exclude the possibility that the two forms of market organization may have different levels of productive efficiency. The assumption is intended, however, to provide that efficiency differences, if present, will be "neutral" with respect to the relative mix of input and output variables.

a monopolist and a competitive industry to produce identical products, albeit at possibly different levels of output.

Given these three assumptions, a firm will produce the same level of product quality regardless of whether the firm is a monopolist or a perfect competitor. In light of the first assumption, a monopolist and a competitor will face the same demand for quality even though a monopolist will tend to produce less physical product than a perfect competitor. In light of the second and third assumptions, a firm, regardless of market structure, will face the same cost constraints when producing a given level of product quality. To the extent that neither demand nor cost vary with market structure, a monopolist and a competitor can be expected to produce goods of the same quality. And, to the extent that a contract is analogous to a product, a monopolist and a competitor will offer contracts of the same quality.

Although none of the three assumptions discussed above has been rigorously tested, the first assumption—that demand for quality is unrelated to physical output—gains support in our everyday behavior. A consumer who pays a premium to purchase a high quality product typically will pay the same premium for the extra quality when he purchases another unit of the product. Assuming, for example, that high-test gasoline is five cents per gallon more expensive than regular gasoline, a consumer will pay the same five cent per gallon premium regardless of whether he purchases one gallon or twenty gallons.<sup>43</sup> The premium consumers pay for quality apparently is independent of the level of output.

Further study is required to prove the foregoing argument that market structure does not affect contract quality and, therefore, does not influence the satisfaction of consumer preferences. As previously noted, the key assumptions underlying the argument are untested. Moreover, economists have only recently begun to explore the relationship between market structure and quality. Their efforts lend some support to the conclusion reached above,

---

<sup>43</sup> An example of this phenomenon in a contractual context is that a consumer probably would pay the same premium for a "full," rather than a "limited," warranty, regardless of whether he enters into one or more contracts. A seller makes a "full" warranty when he agrees to repair and replace defective parts or goods at his own expense, in a reasonable time, and does not limit the duration of implied warranties. A warranty that imposes fewer obligations on a seller is a "limited" warranty. See Magnuson-Moss Warranty—Federal Trade Commission Improvement Act § 103(a), 15 U.S.C. § 2303(a) (Supp. V 1975).

and they certainly have not reached a theoretical consensus supporting the contrary conclusion that a monopolist tends to underproduce quality.<sup>44</sup> Finally, the entire argument rests on the analogy, albeit a strong analogy, between a product and a contract. In sum, the argument is, at best, plausible but unverified.

A court or legislature nonetheless should act as if the argument outlined above were true. Contrary to the unproven conventional wisdom that a monopolist or an oligopolist is less responsive than a competitive seller to consumer preferences regarding contract quality, the foregoing argument presents a plausible theory consistent with the empirical evidence that the content of contracts does not vary with market structure. Further, if monopoly power is a factor that militates against enforcing an agreement, a buyer seeking to invalidate a contract must prove that the seller actively exercised monopoly power. Because market structure apparently is unrelated to contract content, however, it seems unwise to permit courts and litigants to incur the steep costs entailed in establishing

---

<sup>44</sup> For authority suggesting that quality is unrelated to market structure or that a monopolist does not underproduce quality, see J. HIRSCHLEIFER, *supra* note 19, at 316; Pazner, *Quality Choice and Monopoly Regulation*, in REGULATING THE PRODUCT: QUALITY AND VARIETY 3 (R. Caves & M. Roberts eds. 1975); D. Epple & A. Raviv, *Product Safety: Liability Rules, Market Structure and Imperfect Information* (May 1976) (Graduate School of Industrial Administration, Carnegie-Mellon University, Working Paper #74-75-76).

For contrary authority, see Leland, *Quality Choice and Competition*, 67 AM. ECON. REV. 127 (1977); M. Mussa & S. Rosen, *Monopoly and Product Quality* (June 1975) (Department of Economics, University of Rochester, Discussion Paper #75-12). Neither essay resolves the issue. Although demonstrating that a monopolist tends to underproduce quality, as measured by what a consumer would pay for it, Professor Leland assumes, without discussion, that the demand for quality varies with output. By contrast, Professor Pazner emphasized the importance of assuming that the demand for quality is unrelated to output. Pazner, *supra*, at 5-6. Moreover, Leland does not claim that a competitor always produces a higher quality product; rather, he concedes that, under certain circumstances, "it is possible that competition could lead to higher output and lower quality" than monopoly. Leland, *supra*, at 136. Unable to draw a simple inference about product quality from the market structure of an industry, a court that accepted Leland's conclusions would, instead, have to make a complex, and perhaps costly, economic investigation. In their discussion paper, Professors Mussa and Rosen argue that a monopolist who simultaneously produces goods at several quality levels may sometimes degrade the quality of the lowest class of products. Their models, however, rest upon the very strong assumption that a monopolist will engage in a particularly complex form of price discrimination, in which the monopolist recognizes a buyer's tradeoff between quality and price accurately and promptly, and in which the monopolist alters production quickly in order to exploit these tradeoffs. Therefore, the conclusions of Mussa and Rosen must be viewed with skepticism. Further, they have not adapted their model to include oligopoly power—a

that a seller has exercised market power.<sup>45</sup> For these reasons, the existence of monopoly power should militate neither in favor of nor against the enforcement of a contract.<sup>46</sup>

### III. INCOMPETENCE

The foregoing analysis, consistent with traditional contract law, assumed that people act competently to maximize their personal utility. A contrary assumption, however, apparently underlies much of the recent legislation governing consumer contracts. It is now commonly assumed that many people, in particular the poor, cannot competently maximize their utility, because these people are ignorant, inexperienced,<sup>47</sup> or simply bad at making their pref-

---

more prevalent variety of market power where such price discrimination would be even more difficult to conduct.

For authority demonstrating that product durability, an important aspect of quality, is unrelated to market structure, see Parks, *The Demand and Supply of Durable Goods and Durability*, 64 AM. ECON. REV. 37 (1974); Swan, *Durability of Consumption Goods*, 60 AM. ECON. REV. 884 (1970).

<sup>45</sup> The extent to which a firm exercises market power often is the major issue in anti-trust cases. Such cases are time-consuming and expensive. See generally McAllister, *The Big Case: Procedural Problems in Antitrust Litigation*, 64 HARV. L. REV. 27 (1950); Posner, *A Statistical Study of Antitrust Enforcement*, 13 J.L. & ECON. 365 (1970); Withrow & Larm, *The "Big" Antitrust Case: 25 Years of Sisyphian Labor*, 62 CORNELL L. REV. 1 (1976).

<sup>46</sup> Limiting the enforceability of contracts tainted with monopoly power is sometimes justified on distributional grounds. It is argued that, if a court refuses to enforce a monopolist's warranty disclaimer, the monopolist must absorb the resulting costs out of his monopoly profit. Proponents of this view then equate a smaller monopoly profit with a redistribution of wealth from the monopolist to his customers. This view, however, ignores the fact that the monopolist, if a court strikes his disclaimers, is likely to raise the price of the contract or otherwise to impose increased costs on his buyers. Therefore, no redistribution of wealth from the monopolist to his customers will take place. Moreover, as previously discussed, see notes 9-23 *supra* and accompanying text, restricting the enforceability of warranty disclaimers, in fact, will reduce the welfare of some buyers.

<sup>47</sup> For example, the assumption that many persons are too ignorant or too inexperienced to maximize their own satisfaction underlies the provision in the Uniform Consumer Credit Code that lists as a factor relevant to a judicial finding of unconscionability "the inability of the consumer . . . reasonably to protect his interests by reason of . . . ignorance, illiteracy, inability to understand the language of the agreement, or similar factors." UNIFORM CONSUMER CREDIT CODE § 5.108(4)(e). For a similar prohibition, see UNIFORM CONSUMER SALES PRACTICES ACT § 4(c)(1). For a judicial opinion evidencing this assumption of consumer incompetence, see *Johnson v. Mobil Oil Corp.*, 415 F. Supp. 264 (E.D. Mich. 1976). In *Johnson*, the court refused, upon defendant's motion for summary judgment, to enforce against a gasoline station operator an exculpatory clause excluding defendant's liability for consequential damages, partly because:

Plaintiff is 39 years of age. . . . After dropping out of school in the eighth grade, he did farm work, worked in factories, and painted signs. While he was able to testify



erences and purchases congruent.<sup>48</sup> Even though some people are poor at maximizing their own utility, the issue is whether the law should presume that, as a general rule, consumers act competently. The traditional premise of consumer competence,<sup>49</sup> it is argued below, should continue to govern, because the evidence of widespread incompetence is too unreliable to justify the costs of assuming that some consumers cannot act in their own best interests.<sup>50</sup>

In unconscionability cases, courts often infer from the terms of the agreement itself (such as a broad security interest or an apparently extravagant purchase) that a consumer is incompetent.<sup>51</sup>

---

in an understandable manner, it appears that he is practically illiterate. He stated that he cannot read, except perhaps certain items in the sports section of the newspaper. When asked by his counsel to read aloud from the retail dealer contract, he appeared able to read only isolated words.

. . . .

. . . The notion of free will has little meaning as applied to one who is ignorant of the consequences of his acts.

*Id.* at 268-69. The court then ruled that it would not enforce such an exculpatory clause unless the party relying on the clause had obtained "the voluntary, knowing assent" of the other party. *Id.* at 269.

<sup>48</sup> For example, the provision in the Uniform Consumer Credit Code (Code) that lists "the inability of the consumer to receive substantial benefits from the property or services sold" as a factor relevant to a finding of unconscionability rests upon the assumption that some people cannot make their purchases and preferences congruent. UNIFORM CONSUMER CREDIT CODE § 5.108(4)(b). *Accord*, UNIFORM CONSUMER SALES PRACTICES ACT § 4(c)(3). The Code provision thus militates against enforcing "a sale to a Spanish speaking laborer-bachelor of an English language encyclopedia set, or the sale of two expensive vacuum cleaners to two poor families sharing the same apartment and one rug." UNIFORM CONSUMER CREDIT CODE § 5.108, Comment 4. For another example, see *id.* § 1.107(4).

<sup>49</sup> The term "consumer incompetence," as used in the text, refers to the inability of a person to contract in his own best interest, because he is ignorant, commercially unsophisticated, or simply inept. In this sense, traditional contract law did not permit an incompetent consumer to avoid contractual liability. The traditional view, however, recognized a different form of incompetence, arising either where a mentally ill person did not know that he was making a contract at all or where such a person knew that he was making a contract against his own best interest but could not act in a reasonable manner in relation to the transaction. See RESTATEMENT (SECOND) OF CONTRACTS § 18c.

<sup>50</sup> Economists often defend their use of the assumption that people act to maximize expected utility, not because the assumption is true, but because it has explanatory and predictive power. See R. POSNER, *ECONOMIC ANALYSIS OF LAW* 12-14 (2d ed. 1977). See also Bray, *The Logic of Scientific Method in Economics*, 4 J. ECON. STUD. 1 (1977). Professor Sen recently criticized the standard notion that persons act to maximize expected utility, but agreed that his criticism did not apply "in the private purchase of many consumer goods." Sen, *Rational Fools: A Critique of the Behavioral Foundations of Economic Theory*, 6 PHIL. & PUB. AFFAIRS 317, 330 (1977). Adding to the economists' "positivist" justification, this section of the article presents a normative argument to justify the assumption that people act to maximize their expected utility.

<sup>51</sup> *E.g.*, *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965).

This approach, however, is circular: the party is ruled incompetent because the deal is bad, while the deal is ruled bad because the party is incompetent. Although the content of a contract is often relevant to whether a consumer has acted competently,<sup>52</sup> a court or legislature that inferred incompetence only from the terms of a contract would in fact be banning a clause for substantive reasons alone. The question of whether, in a given case, the substantive objections to a clause, standing alone, are sufficiently compelling to justify nonenforcement should be faced openly, not concealed in the apparently neutral language of behavioral judgments.

Inferences of incompetence, however, are sometimes based on evidence extrinsic to the terms of an agreement. But these inferences rarely are drawn by experts—psychiatrists or psychologists; they reflect judgments about large groups rather than the results of individual examinations or controlled experiments; and they are often based on anecdotal evidence or subjective impressions. For example, a lawyer-scholar, influential in the consumer protection movement, once argued:

[T]he consumer is often so preoccupied with achieving his primary objective of obtaining credit that he does not evaluate any creditor's offer of exchange in terms of whether the benefit sought is to be paid for at a higher price, in terms of dollars and relinquishment of rights, than he perhaps should pay. The lack of sensitivity to contract terms tends to prevent the consumer from considering alternative arrangements that may be available to him in the market. . . .<sup>53</sup>

Also, a frequently cited note asserted:

Low income consumers are frequently concerned to satisfy non-material needs by their purchases: status seeking and escapism heavily influence their buying patterns. . . . Many of the poor are shy and unwilling to deal with strangers . . . . Low income consumers . . . are . . . generally less able to make rational choices among products than their middle income counterparts. . . . A low income consumer is profoundly different from a middle income consumer . . . . Underlying his problems . . . is a crucial lack of motivation. Many of the poor . . .

---

<sup>52</sup> Cf. Wilbert, Jorstad, Loren & Wirrer, *Determination of Grave Disability*, 162 J. NERVOUS & MENTAL DISEASE 35 (1976) (evaluating the competency of persons thought to be mentally ill, in part by analyzing their behavior as consumers).

<sup>53</sup> CUITAN, *Legislative Controls As A Response To Consumer-Credit Problems*, 8 B.C. IND. & COM. L. REV. 409, 436 (1967).

no longer regard the attempt [to get more for their money] as worthwhile.<sup>54</sup>

Inferring incompetence in this manner is objectionable, not because such inferences have been proven false, but rather because the evidence is in fact inconclusive. With regard to the evidence, the previously quoted note reflects the common assumption that the poor are much less competent than the middle class at maximizing their personal utility.<sup>55</sup> Empirical studies of the behavior of poor consumers, however, often contradict this assumption. A recent case study of rural poor families concluded:

[P]oor people do perceive and act in accordance with marginal costs and returns. . . . They are . . . close to their optimum given their circumstances, which is the most we can say of anybody. This means it is appropriate to assume . . . that the poor behave rationally and in their best interests.<sup>56</sup>

Another study examining the consumer credit behavior of 650 "representative" households and 150 black families observed: "In general low-income and minority buyers appear to have realistic perceptions of the structure of the credit market, at least by comparison with other groups in the population."<sup>57</sup> Although some studies do suggest that poor people are incompetent consumers,<sup>58</sup>

---

<sup>54</sup> Note, *Consumer Legislation and the Poor*, 76 YALE L.J. 745, 750-54 (1967) (footnotes omitted). The note drew its primary support from the apparently uncorroborated congressional testimony of people who worked with the poor. See also Wallace, *The Uses of Usury: Low Rate Ceilings Reexamined*, 56 B.U. L. REV. 451, 476, 494 (1976) (alleging, without empirical support, that some high risk buyers are incompetent).

<sup>55</sup> For other authorities assuming that the poor are significantly less competent than the middle class, see Katz, *Introduction to THE LAW AND THE LOW INCOME CONSUMER* at i (C. Katz ed. 1968); Black, *Some Notes on Law Schools in the Present Day*, 79 YALE L.J. 505, 508 (1970); Caplovitz, *Consumer Credit in the Affluent Society*, 33 LAW & CONTEMP. PROB. 641, 647-49 (1968); articles cited note 10 *supra*.

<sup>56</sup> Newton, *Economic Rationality of the Poor*, 36 HUMAN ORGANIZATION 50, 58 (1977).

<sup>57</sup> Day & Brandt, *A Study of Consumer Credit Decisions: Implications for Present and Prospective Legislation*, in THE NATIONAL COMMISSION ON CONSUMER FINANCE, 1 TECHNICAL STUDIES 95 (1972). See also *id.* at 29-30, 112-16. For similar evidence that the demographic variables of race and income do not significantly correlate with unwise or uninformed consumer behavior, see Deutscher, *Credit Legislation Two Years Out: Awareness Changes and Behavioral Effects of Differential Awareness Levels*, in THE NATIONAL COMMISSION ON CONSUMER FINANCE, 1 TECHNICAL STUDIES 42 (1972); Mandell, *Consumer Perception of Incurred Interest Rates: An Empirical Test of the Efficacy of the Truth-In-Lending Law*, 26 J. FINANCE 1143 (1971); White & Munger, *Consumer Sensitivity To Interest Rates: An Empirical Study of New-Car Buyers and Auto Loans*, 69 MICH. L. REV. 1207 (1971).

<sup>58</sup> See THE NATIONAL COMMISSION ON CONSUMER FINANCE, *CONSUMER CREDIT IN THE UNITED STATES* 175-78 (1972).

the empirical evidence is inadequate to justify an assumption that poor people in general are too ignorant, too inexperienced, or too inept to maximize their own utility.<sup>59</sup> Before intervening to strike a contract clause, a court or legislature, therefore, should require strong evidence of such incompetence, because people who are wrongly classified as incompetent are significantly disadvantaged.

There apparently are few studies that directly evaluate the consuming behavior of middle class persons. Recent studies of "token" economies, however, illuminate this question.<sup>60</sup> These studies examine the response of patients in mental hospitals to economic incentives, such as higher wages for doing particular tasks or changes in the relative prices of goods the patients are allowed to purchase. The major advantage of these studies is that many extraneous variables can be excluded, because the entire "economy" is under the experimenter's control. The seminal token economy study observed: "Patients were sensitive to the response-reinforcement relationship [*i.e.* to changes in wages] in spite of the fact that many had extremely low IQ's, a severe state of psychosis, and often a minimal level of verbal comprehension."<sup>61</sup> These experimental results, that patients respond to economic incentives as economic theory predicts for normal persons, have frequently been replicated.<sup>62</sup>

---

<sup>59</sup> Newton may have suggested a theory that helps to explain the data respecting poor consumers when he quoted an AFDC mother of eight as saying:

Listen honey, if you want to see how people spend their money on things they don't need, and don't know much about what they are getting, and may buy it even so without thinking ahead, you'd better go study rich folks. If I wasted money like that, I'd be dead . . . .

Newton, *supra* note 56, at 50.

<sup>60</sup> With regard to conclusions about the competence of middle class consumers, these studies have two important limitations. First, the studies, which report only aggregate data, do not examine separately the behavior of middle class patients. But plainly many of the subjects in the token economy experiments were middle class patients. Second, the studies examine only responses to relatively simple economic stimuli, such as changing prices. The experiments do not involve complex consumer transactions.

<sup>61</sup> Ayllon & Azrin, *The Measurements and Reinforcement of Behavior of Psychotics*, 8 J. EXPERIMENTAL ANALYSIS OF BEHAVIOR 357, 374 (1965). For more recent data, see Battalio, Kagel, Winkler, Fisher, Basmann & Krasner, *A Test of Consumer Demand Theory Using Observations of Individual Consumer Purchases*, 11 W. ECON. J. 411 (1973) ("Chronic psychotics" responded to changes in relative prices as economic theory would predict for normal persons; data limitations made the conclusion valid for approximately half the sample.)

<sup>62</sup> See Gripp & Magaro, *The Token Economy Program in the Psychiatric Hospital: A Review and Analysis*, 12 BEHAVIORAL RESEARCH & THERAPY 205, 219-20 (1974). A question

The costs of an overinclusive classification of incompetence are twofold. First, an overinclusive classification based on poverty stigmatizes the poor, as being unable to do what "ordinary" people can do.<sup>63</sup> Second, overinclusive classifications unnecessarily restrict a competent consumer's freedom to contract. For example, the Uniform Consumer Sales Practices Act lists, as a factor relevant to a finding of unconscionability, the fact that a seller "knew or had reason to know" that he had taken advantage of a consumer's inability reasonably to protect his interests due to the consumer's incompetence.<sup>64</sup> In light of the recent trend towards increased consumer protection, courts are likely to interpret the phrase "had reason to know" as imposing upon sellers a substantial duty to investigate the competence of consumers. Because such individualized investigations are apt to be too costly to conduct in mass transactions, a seller operating in such a market might refuse to

---

that experiments like this raise is whether the sample studied accurately reflects the population at large. "External validity," however, does not seem a problem here because mental patients would seem more likely to behave irrationally than would normal persons. Thus, the fact that such patients act competently and predictably to maximize their own utility is strong evidence that normal persons of similar socioeconomic status also so act.

<sup>63</sup> Professor Goldstein recently argued against imposing such a stigma on persons in a context where interference with individual freedom seems intuitively justifiable. In a paper evaluating "the competence and freedom of the institutionalized mentally infirm . . . to make a choice for or against involvement in biomedical research," he recommended that the state presume, as a general rule, that the mentally infirm are competent to make such a choice, and that the state should concern itself with ensuring that the mentally infirm make informed and free choices. This recommendation partly rested on the following argument:

Like the small print on standard contract forms, the signed standard "informed consent" form . . . should not constitute an automatic defense. On the other hand, the common law rule which presumes the *competence* of all adults to decide for themselves should generally prevail so far as the researcher's claim that a subject or potential subject, even if from the population of institutionalized mentally infirm, had the capacity . . . to choose. To presume otherwise would be to deprive the mentally infirm and/or the institutionalized person of his or her entitlement to respect as a human being. Thus to deny such persons the right to decide whether to participate in research because he or she is incompetent is to reduce that person's individual autonomy beyond that which can be justified by the designation or the incarceration.

J. Goldstein, *On the Right of the "Institutionalized Mentally Infirm" to Consent to or Refuse to Participate as Subjects in Biomedical and Behavioral Research* 25 (1976) (emphasis in original) (submitted to the National Commission for the Protection of Human Subjects of Biomedical and Behavioral Research).

<sup>64</sup> See UNIFORM CONSUMER SALES PRACTICES ACT § 4(c); cf. UNIFORM CONSUMER CREDIT CODE § 5.108 (similar provision but applicable only where seller actually knew about the consumer's incompetence).

deal with, or raise prices to, persons belonging to groups in which a substantial percentage of members are likely to be judged incompetent. These groups would probably be defined in terms of race, wealth, and other sociologically obvious characteristics. As a result, some members of social groups, such as poor blacks and Chicanos, would face unnecessary restrictions upon their freedom to contract.<sup>65</sup>

In sum, an overinclusive classification of incompetence creates both unfair stigmatization and undue restrictions upon freedom to contract. Moreover, the rigorous evidence that now exists does not strongly support—indeed, it tends to contradict—the assumption that many consumers are incompetent. Therefore, a court or legislature should not allow the possibility of consumer incompetence to militate against enforcing a contract.<sup>66</sup>

#### IV. CONCLUSION

When invoking the doctrine of unconscionability to invalidate a contract, a court or legislature typically requires the existence of a nonsubstantive objection to the enforcement of the agreement. Nonsubstantive objections arise when a buyer is poor or incompetent or when a seller exercises monopoly power or fails to particularize his contracts. This article demonstrates that none of these

---

<sup>65</sup> As another illustration, the Uniform Consumer Credit Code provides that sellers may only take purchase money security interests when making consumer sales. UNIFORM CONSUMER CREDIT CODE § 3.301. This restriction apparently assumes that buyers cannot evaluate competently the benefits they would receive in exchange for other types of security interests. To the extent that consumers use their earning power and personal property as security, a statute that restricts the use of the latter increases the significance of the former as a determinant of whether to give credit. The FTC has proposed a regulation to extend this restriction to jurisdictions not adopting the Code and to restrict the ability of lenders to secure loans with consumers' personal property. See note 16 *supra*.

<sup>66</sup> It is sometimes argued that consumer contracts transmit more information than most consumers can absorb, and thus that many consumers, in a meaningful sense, are incompetent to maximize their utility. See Davis, *supra* note 27, at 847-50. Similarly, it is sometimes argued that consumers are poor at foretelling the future; that is, they make decisions that irrationally favor present, rather than future, consumption. *E.g.*, Whitford & Laufer, *The Impact of Denying Self-Help Repossession of Automobiles: A Case Study of the Wisconsin Consumer Act*, 1975 WIS. L. REV. 607, 616. Both arguments involve informational objections, see note 6 *supra* and accompanying text, and therefore are beyond the scope of this article. There is, however, little evidence supporting these claims. For a summary of the data, pro and con, respecting the claim that consumers have a quite limited ability to process information, see J. Bettman, *Consumer Information Acquisition and Search Strategies* (June 1977), to be reprinted in *THE EFFECT OF INFORMATION ON MARKET BEHAVIOR* (A. Mitchell ed. 1978).

objections support a decision to invalidate a contract. To the contrary, the objection relating to poverty actually weighs in favor of enforcing an agreement.

The arguments outlined above, however, assume that a contracting party has the information necessary to make rational choices in the marketplace. While this assumption is sometimes false, there is a shortage of rigorous analysis concerning how inadequate information influences the content of contracts and how the state should respond when information seems inadequate.<sup>67</sup> This shortage is unfortunate, because a party's lack of information is the only remaining factor of nonsubstantive unconscionability that tenably supports a decision to invalidate an agreement. Further research, therefore, is required to illuminate the problem of inadequate information and to ascertain whether the present substantive objections to contract enforcement, standing alone, are now sufficient to justify nonenforcement under the unconscionability doctrine.

---

<sup>67</sup> The literature includes few empirical studies that examine the effect of inadequate information. For two empirical studies that do explore the effect of information gaps, see Fujii, *On the Value of Information on Product Safety: An Application to Health Warnings on the Long Run Medical Implications of Cigarette Smoking*, 30 *PUB. FINANCE* 323 (1975); Marvel, *The Economics of Information and Retail Gasoline Price Behavior: An Empirical Analysis*, 84 *J. POL. ECON.* 1033 (1976). For a thoughtful analysis of the unresolved problems in the theoretical literature, see Rothschild, *Models of Market Organization with Imperfect Information: A Survey*, 81 *J. POL. ECON.* 1283 (1973). For a recent attempt to clarify some of these theoretical issues, see L. Wilde & A. Schwartz, *Equilibrium Comparison Shopping* (June 1977) (California Institute of Technology, Social Science Working Paper # 184). Thus, it is premature to adhere to the frequently asserted claim that the existence of inadequate information justifies market interventions, such as restricting contracts, providing more information, or reducing search costs. Further research comparing the administrative costs of intervention and the efficiency costs of inaction is required. For a discussion of other aspects of the question of whether to require disclosure or to regulate substance, see Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 *WIS. L. REV.* 400.