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POSSIBILITY AND PLAUSIBILITY IN LAW AND ECONOMICS

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I. INTRODUCTION

In attempting to provide policy advice to judges, legislators, administrators, and other legal actors, law and economics scholarship pays close attention to the incentive effects that legal rules have on the citizens subject to them. This consequentialist focus on the effects of law means that law and economics scholarship requires a descriptive account of how people do (or will) react to various possible legal regimes. Traditionally, scholars in the field have relied on rational choice theory (RCT) for this account, although there has always been diversity in the precise vision of rational behavior that researchers assume. Some researchers assume that actors will seek to maximize their wealth, while others assume only that actors will seek to maximize their broader self-interest. Still others make no assumptions about "ends," assuming only that actors will maximize their subjective expected utility, however defined.[1] Some researchers assume actors act on perfect information, while others assume that actors acquire information only to the point at which the marginal costs of acquisition exceed the marginal benefits.[2] Despite the variations as to specifics, rationalist accounts of behavior are notable for assuming optimizing behavior on the part of actors.[3]

Perhaps as few as ten years ago, and certainly as few as fifteen, the notion that researchers should base their analyses on behavioral assumptions that are inconsistent with RCT—that is, that actors do

* Professor of Law, UCLA. Helpful comments from Iman Anabtawi, Steve Bainbridge, Tom Ulen, and participants of the Florida State University College of Law's symposium on the Behavioral Analysis of Legal Institutions are gratefully acknowledged.

1. *See generally* Russell B. Korobkin & Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption from Law and Economics*, 88 CAL. L. REV. 1051, 1060-66 (2000).

2. This strand of RCT thinking became widespread as a result of Stigler's work. *See* George J. Stigler, *The Economics of Information*, 69 J. POL. ECON. 213 (1961).

3. *Cf.* Gerd Gigerenzer, *Striking a Blow for Sanity in Theories of Rationality, in* MODELS OF A MAN: ESSAYS IN MEMORY OF HERBERT A. SIMON 389, 390-95 (Mie Augier & James G. March eds., 2004) (distinguishing theories of bounded rationality from theories of optimization under constraints).

not, at a minimum, maximize their expected utility given available information—was virtual heresy in the law and economics community.[4] This is not to say that law and economics scholars did not believe that people's actions deviate at times from the optimization assumption of RCT; rather, that this aspect of reality was simply not useful for the purpose of devising legal policy because deviations were random and unpredictable, because competition would drive such errors out of legal markets, or because adding new elements to behavioral models would complicate analysis to the point that prediction would become impossible.

Today, the approach to scholarly inquiry often called "behavioral law and economics," which draws on the interdisciplinary behavioral-decision-theory (BDT) literature for its behavioral assumptions, is recognized as an acceptable methodology, if not yet the dominant one, in the mainstream law and economics community. That is, most law and economics scholars would agree with the statement that citizens often behave in ways not predicted by RCT, and that taking into account the ways in which actors deviate in their decisionmaking behavior from the predictions of RCT can, in at least some instances, enrich our understanding of law-relevant behavior and improve the quality of normative legal policy prescriptions.

The general acceptance of the behavioral law and economics approach raises an important methodological question for law and economics scholars. For purposes of deriving policy recommendations, how should the researcher determine whether to assume strict RCT behavior or something more consistent with the BDT literature, such as bounded rationality or susceptibility to cognitive biases? Although most scholars now are willing to assume that strict rationality is neither ubiquitous nor always the most useful behavioral assumption for the purposes of crafting legal scholarship, this does not suggest that the opposite is true. That is, it is almost certainly the case that in many law-relevant situations, many actors evaluate information in a relatively unbiased way, make decisions that maximize their expected utility given available information, and implicitly measure utility in terms of their selfish interest. Notwithstanding recent accusations to the contrary,[5] most legal scholars who

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4. This generalization should not, of course, be interpreted as a claim that all law and economics scholars rejected non-RCT assumptions. Challenges to the optimization assumption by interdisciplinary luminaries such as Herbert Simon and Oliver Williamson have long been well known, if mostly disregarded in practice, in the law and economics community. *See, e.g.*, Herbert A. Simon, *A Behavioral Model of Rational Choice*, 69 Q.J. ECON. 99 (1955); Herbert A. Simon, *Rational Choice and the Structure of the Environment*, 63 PSYCHOL. REV. 129 (1956); Oliver E. Williamson, *Markets and Hierarchies: Some Elementary Considerations*, 63 AM. ECON. REV. 316 (1973).

5. *Compare* Gregory Mitchell, *Why Law and Economics' Perfect Rationality Should Not Be Traded for Behavioral Law and Economics' Equal Incompetence*, 91 GEO. L.J. 67

identify with the behavioral law and economics movement would agree with this statement.

Professor Klick's comment in this symposium issue,[6] which responds to my previously published work on the subject of standard form contracts, implicitly provides two answers to this methodological question. The first response, which I think resonates quite clearly in Klick's comment, can be paraphrased as follows: the scientific method should be used to determine whether an RCT-based or BDT-based assumption is empirically accurate in the law-relevant circumstances under consideration. The second response is that, until proven otherwise, researchers should presume that citizens act in accordance with RCT. Admittedly, this latter response is less clearly implied by Klick than the former, but I think it is a fair reading of his article.

In this rejoinder to Klick, I argue that the first response is unobjectionable but often not helpful for the purposes of legal scholarship, and that the second response should be rejected. Instead, I propose that the choice between using an RCT-based behavioral assumption and a BDT-based behavioral assumption in law and economics analysis should turn on the relative plausibility of competing accounts in light of existing knowledge, which is often incomplete and indeterminate.

This Comment proceeds in three parts: Part II agrees with Klick that law and economics scholars should attempt to rely on the scientific method to understand law-relevant behavior but argues that, in practice, this goal will often prove elusive. Part III rejects Klick's implication that RCT-based behavioral assumptions should be presumed true unless proven false—what I will call the "possibility" argument. Part IV proposes and defends the alternative methodological standard of relative "plausibility." Part V concludes.

II. THE SCIENTIFIC METHOD

In a world of no transaction costs and perfect information-processing capabilities among buyers, seller-drafted standard form contracts should include only efficient terms, meaning that no alternative set of terms would make buyers and sellers jointly better off.[7] If the market is competitive, only sellers who offer efficient

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(2002) (claiming that BDT proponents assert that actors always act inconsistently with RCT), *with* Robert A. Prentice, *Chicago Man, K-T Man, and the Future of Behavioral Law and Economics*, 56 VAND. L. REV. 1663, 1722 (2003) (calling Mitchell's claim "a giant straw man").

6. Jonathan Klick, *The Microfoundations of Standard Form Contracts: Price Discrimination vs. Behavioral Bias*, 32 FLA. ST. U. L. REV. 555 (2005).

7. For an excellent explication of this reasoning, see Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361 (1991).

terms could succeed in attracting buyers.[8] A monopolistic seller could offer inefficient terms without losing all of his customers, but he will maximize his profit in most cases by offering an efficient set of terms and charging a monopolistic price rather than by offering inefficient seller-preferred terms and a correspondingly lower price.[9]

Based on a BDT-based behavioral assumption derived from empirical research on consumer decisionmaking, I have argued that standard form contracts are likely to contain inefficient terms because most buyers will compare only a subset of product attributes ("salient" attributes) among sellers when making a purchase decision, even when all contract terms are readily available and, thus, RCT would suggest that buyers would implicitly price all of them as part of the purchase decision.[10] Because making nonsalient attributes "low quality" will save the seller money and not cost the seller customers, sellers will have a profit incentive to skimp on quality for such attributes. If price is a salient attribute for buyers, sellers in a competitive market will actually be forced by market pressure to make nonsalient attributes low quality, whether or not this is the efficient level of quality for those attributes. This is because they will need the resulting cost savings in order to compete on price, which they must do to retain customers.[11] Reputational costs will provide a counterweight to this tendency, but if buyers are unlikely to learn the true quality of a nonsalient attribute after making a purchase, this constraint is substantially weakened.[12]

Because form terms will often be nonsalient attributes to buyers, and because the content of such terms will become known to buyers only infrequently even after purchase (they usually become relevant only in the unusual case in which something goes wrong), sellers will often have an incentive to draft self-serving form terms without regard to efficiency.[13] On the basis of this logic, I critique the current judicial attitude toward challenges to the enforceability of standard form contracts and present a normative argument for how legal doctrine can be adjusted to better promote contractual efficiency.[14]

Klick agrees, at least arguendo, that standard form contracts contain at least some inefficient terms,[15] but he offers a competing

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8. *See, e.g.*, RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW § 4.8, at 116 (6th ed. 2003).

9. *See, e.g.*, Craswell, *supra* note 7, at 372.

10. Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203, 1243-44 (2003).

11. *Id.*

12. *Id.* at 1239-42.

13. *Id.* at 1243-44.

14. *Id.* at 1244-95. The particulars of my policy argument are not important for the purposes of this Comment.

15. Klick, *supra* note 6, at 556.

hypothesis for why this is the case. His hypothesis, which is consistent with an RCT-based set of behavioral assumptions, is that sellers provide inefficient terms (presumably inefficient terms that are favorable to sellers) to price discriminate among buyers.[16] Buyers with a high value for time will rationally accept the form terms, giving a windfall to sellers.[17] Buyers with a lower value for time will choose (rationally) to haggle over the inefficient and undesirable (to buyers) terms, at which point sellers will give ground to make the sale.[18] By forcing buyers to separate themselves into two types, sellers will increase profits.[19]

The two behavioral hypotheses offered by Klick and myself might lead to very different policy implications. My theory suggests that efficiency in contracting could be enhanced if courts refuse to enforce form terms in some instances. Under Klick's theory, it is less clear that state interference with form contract terms could enhance overall efficiency. This raises the question of which behavioral assumption we should rely upon—my BDT-based assumption or Klick's RCT-based assumption—as the basis for further analysis of how the law should treat standard form contracts. Klick suggests that we ought to derive testable predictions from both assumptions, with particular focus on where the assumptions lead to different predictions, and then conduct research to determine which assumption receives empirical support in the real world.[20]

In theory, Klick's proposal is eminently sensible, and I certainly support the widespread drumbeat for legal scholars to conduct more empirical analysis than our corner of the academy has produced historically.[21] Yet the proposal also has a certain ivory-tower sensibility to it that fails to adequately account for an important practical difference between the purpose of legal scholarship and that of scholarly work in other disciplines. Legal scholarship seeks to provide policy guidance to lawmakers, and waiting for definitive empirical support for a behavioral assumption before action is taken

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16. *Id.* at 564.
17. *Id.* at 565-66.
18. *Id.*
19. *Id.*
20. *Id.* at 569 ("[E]mpirical testing is clearly important before we advance policy prescriptions regarding the treatment of standardized terms in the courts."); *id.* at 561 (stating that my behavioral theory should be tested empirically before the policy prescriptions that follow are adopted).
21. *See, e.g.*, Michael Heise, *The Importance of Being Empirical*, 26 PEPP. L. REV. 807, 810-15; Craig Allen Nard, *Empirical Legal Scholarship: Reestablishing a Dialogue Between the Academy and Profession*, 30 WAKE FOREST L. REV. 347, 348-51 (1995); Richard A. Posner, *Against Constitutional Theory*, 73 N.Y.U. L. REV. 1, 11-12 (1998); Peter H. Schuck, *Why Don't Law Professors Do More Empirical Research?*, 39 J. LEGAL EDUC. 323, 333-35 (1989). *See generally* Symposium, *Empirical and Experimental Methods in Law*, 2002 U. ILL. L. REV. 789 (generally lauding empirical legal scholarship and encouraging more of it).

often equates with maintaining the status quo ante, whatever it may be, and on whatever behavioral assumption it may be based. The reality is that we rarely generate uncontestable empirical results relevant to important legal questions in any kind of a timely way.[22] While this is surely a goal worth striving for, it is not one that we are likely to attain all that often.

There are multiple reasons for this. The most obvious is that careful empirical testing of law-relevant behavior in specifically defined settings is both time- and resource-intensive, and the list of topics that would benefit from such study is quite long compared to the list of scholars doing this work. Potentially even more troubling, however, is that the data required for such studies is often impossible (or virtually impossible) to obtain and, even when it can be obtained, the results themselves or the implications to be drawn from the results will often be contestable and ultimately indeterminate.[23]

Consider, for example, Klick's claim that my behavioral model implies that inefficient, seller-preferred terms should be more likely to appear when consumers are "more homogenous" (because terms that are nonsalient to some customers, and therefore exploitable, will be nonsalient to most or all), while "the price discrimination model suggests that [such] terms are more likely when consumer heterogeneity is greater."[24] Imagine that a dedicated researcher relied on this statement as the basis for his efforts to conduct a test to determine which of the two theories is empirically justified. First, the researcher would have to develop methods for determining which terms found in form contracts are efficient and which are inefficient, for identifying all members of the customer class, and for measuring the heterogeneity of customers. I would like to be proven wrong, but I doubt that either Klick or I will be walking and talking, much less writing, when this feat is accomplished. The task is not theoretically impossible, but it would be quite difficult in practice. Second, the researcher would have to apply this methodology to many contracts in many industries in order to have enough statistical power to ensure that the test results are significant and to ensure that results are not idiosyncratic to, say, the widget industry. Third, the results would have to show a strong correlation—rather than a weak one—between either heterogeneity or homogeneity of buyer preferences

22. *See* Russell Korobkin, *Empirical Scholarship in Contract Law: Possibilities and Pitfalls*, 2002 U. ILL. L. REV. 1033, 1036-37 (identifying fewer than thirty empirical studies specifically tied to arguments about contract law doctrine over a fifteen-year period).

23. *See id.* at 1056-61 (critiquing the usefulness of empirical studies to normative arguments about contract law); *cf.* Eric A. Posner, *Economic Analysis of Contract Law After Three Decades: Success or Failure?*, 112 YALE L.J. 829, 864-65 (2003) (arguing that economic models are often indeterminate because we lack sufficient information about empirical conditions and it is unlikely that we will ever have better information).

24. Klick, *supra* note 6, at 568.

and inefficient form terms. This is possible, but obviously not guaranteed.

Finally, let us assume that the researcher determines that as heterogeneity in buyer preferences increases, the presence of inefficient, seller-preferred terms also increases. Should we then conclude that the price discrimination hypothesis has won the empirical competition? I certainly do not think so, because there are explanations consistent with my theory that would explain why sellers might provide inefficient form terms even if consumer preferences are heterogeneous. For example, it might be that within a heterogeneous buyer population there is a strong correlation between a certain preference type and the propensity to complain about seller performance or to file lawsuits. This could create an incentive for sellers to draft inefficient form terms that tend to be nonsalient to the desired ("profitable") type of buyer and tend to be salient to the undesired ("unprofitable") type of buyer, thus driving away the latter without deterring the former.[25] In other words, a correlation between inefficient terms and buyer heterogeneity is not necessarily inconsistent with my behavioral theory.

My goal is neither to take issue with Klick's call for empirical testing of competing hypotheses, which is certainly a useful thing to do, nor to take issue with his suggestions concerning what particular empirical tests might make sense in this context. Rather, my claim is merely that lawmakers, and therefore legal scholars who wish to provide them with policy advice, often do not have the luxury of demanding clear, irrefutable, empirical proof of a behavioral assumption's veracity in a particular law-relevant context, because such proof is likely to be a long time in coming and may never come at all. In the case of standard form contracts, I am skeptical that we will ever have empirical evidence that decisively vanquishes either Klick's theory or mine. If I am correct about this, the obvious question is, how should law and economics scholars proceed?

III. A RATIONAL CHOICE THEORY DEFAULT ASSUMPTION?

Regardless of how difficult it might be to conduct an empirical competition between my BDT-based behavioral assumption and Klick's competing RCT-based assumption, two facts seem beyond argument: (1) no such competition has been conducted to date, and (2) notwithstanding this, courts and legislatures must deal with the fact of standard form contracts every day. Since the policy implications of the two behavioral assumptions are different (at least arguably), how should we determine which assumption to rely upon

25. *See* Korobkin, *supra* note 10, at 1238-39.

for the purpose of advising legal policymakers?

As much as behavioral law and economics has become accepted as a research methodology, my sense is that, within the law and economics community, there is still a strong tendency to view RCT as the default set of behavioral assumptions. The primary manifestation of this is the emphasis among some law and economics scholars on "possibility stories." Confronted with an explanation of behavior that appears inconsistent with usual RCT assumptions, the law and economics scholar contrives a narrative that explains the observed behavior in a way that is consistent with RCT.

For example, a first-order RCT prediction might be that popular restaurants with more demand than capacity would raise their prices so that the market will clear. Observing long lines outside of a popular restaurant, a law and economics scholar might offer the explanation that lines will create "buzz" for the restaurant, and that the expected increase in long-term profits as a result of the reputational capital the restaurant thereby creates will outweigh the short-term profits being sacrificed by holding prices below the market-clearing level. While inconsistent with the standard premise that price will rise when demand exceeds supply, this creative explanation harmonizes the empirical observation with RCT. The problem is not that the explanation is necessarily wrong; it is that RCT is sufficiently malleable that any mildly clever economist can conjure up a possibility story to explain virtually any empirical observation, so there is no a priori reason to assume that the explanation is right.

Klick's paper is an example of such a possibility story. Confronted with my claim that inefficient form contract terms are the result of buyers' limited cognitive resources, which causes them to limit the data that they analyze as part of their purchase decision, he presents an alternative hypothesis consistent with a RCT-based set of behavioral assumptions: Sellers use inefficient terms as a price discrimination technique that will maximize their profits.[26]

There is nothing inherently objectionable to responding to BDT-based theories with RCT-based possibility stories. It is always sensible to consider multiple explanations for an observed outcome before assuming one is correct and proceeding to develop policy recommendations on the basis of it. But I think that there is more going on here than brainstorming. The implication of RCT-based possibility stories is that they serve to trump all but the most airtight BDT-based explanations. As Klick writes, law and

26. Klick, *supra* note 6, at 564.

economics scholars

> should be careful not to invoke behavioral explanations—developed atheoretically on the basis of observation as opposed to rigorous testing—simply because existing economic theory is not borne out empirically. Instead, we should adopt behavioral explanations only if they can explain systematic cross-sectional and time-series variation, *while keeping in mind that conventional theory might provide some unexplored insights*.[27]

The subtext, I think, is that RCT assumptions should be the default standard, and that a possibility story consistent with RCT should be given preference over a BDT-based explanation unless and until the BDT-based theory is definitively proven beyond all doubt.

In his conclusion, Klick warns that "we need to be more hesitant in using insights from psychology to rationalize unexpected empirical observations ex post,"[28] which again, I think, has the subtext that BDT-based explanations are entitled to citizenship in the law and economics nation, but only second-class citizenship. It is preferable to rationalize unexpected empirical observations with accounts that are consistent with RCT rather than with accounts that are not.

Although I might be reading more into Klick's paper on this point than is actually there, I am quite sure that the default RCT presumption is held by many, if not most, law and economics scholars. The reason for this, I believe, is rooted in two core myths, neither of which is true: (1) RCT-based explanations of behavior are more parsimonious than their BDT-based cousins,[29] and (2) RCT-based explanations are better able to generate testable, falsifiable predictions.[30]

Parsimony may be an aesthetic virtue for those inclined to mathematical modeling, but it has little virtue in a behavioral assumption that underlies a claim about what legal policy is most efficacious in a particular, well-defined context.[31] If we wish to devise recommendations for how courts or legislatures should address standard form contracts, the best theory is the most accurate one, not the leanest. In any event, it is not necessarily the case that RCT-based theories are more parsimonious than BDT-based theories. Klick's theory assumes that buyers will implicitly price all form contract terms as part of their purchase decision (this is essential for

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27. *Id.* at 557-58 (emphasis added).

28. *Id.* at 569.

29. *See, e.g.*, Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN. L. REV. 1551, 1559-60 (1998).

30. *See, e.g.*, Klick, *supra* note 6, at 557 ("[T]he comparative advantage of [non-behavioral] economic analysis [is that it] generates testable hypotheses about cross-sectional and time-series variation in behavior.").

31. *See* Korobkin & Ulen, *supra* note 1, at 1072.

buyers to determine whether it is worth their time to bargain for better terms); my theory assumes that buyers will price only a subset of salient terms. It is true that my theory begs the question of how buyers will determine which terms are salient, and another layer of theory is needed to address this issue. But Klick's theory begs the question of which terms sellers will use as vehicles for price discrimination, which the first cut of his theory does not specify. Klick's theory also requires the assumptions that bargaining is costly and information acquisition is not costly, while my theory does not require any assumptions about the costs of bargaining or of information acquisition.

It is often claimed that RCT generates testable predictions ex ante, whereas BDT-based explanations are ad hoc, ex post explanations devoid of a theory that cannot generate determinate predictions.[32] This charge is also grossly unfair. RCT generates a determinate set of predictions only in its thinnest form, and at this level the predictions are not testable. What I have called the "definitional" version[33] of RCT predicts that individuals will act to maximize their subjective expected utility (SEU). The problem is that SEU cannot be observed, so the prediction is not testable. RCT adherents often infer from the actions an individual actually takes what actions maximize his SEU,[34] but this sleight of hand reduces RCT to a tautology. To make RCT-based theories falsifiable, the theorist must make choices about a series of assumptions—choices that are ad hoc and ex post. Klick's comment demonstrates this problem. If we assume low transaction and information acquisition costs, we would predict that terms in standard form contracts would always be efficient. If we assume that bargaining costs are high, as Klick's theory implicitly does, sellers might use inefficient terms to price discriminate between buyers with high and low time values. But, then again, this prediction is consistent with RCT only if we implicitly assume that the benefit of price discrimination for sellers exceeds the costs to them of haggling with low-time-value buyers. If seller transaction costs are high, it is more likely that they will draft only efficient terms and not haggle.

In other words, RCT does not provide a determinate set of falsifiable behavioral predictions because RCT-based predictions always require assumptions about factors like individual utility functions, transaction costs, information acquisition costs, and the like. Law and economics scholars can (and do) create testable predictions by specifying these parameters, but if subsequent data is

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32. *See, e.g.*, Posner, *supra* note 29, at 1559 (claiming that predictions as to what "rational man" would do in a situation are clear, whereas predictions of what "behavioral man" would do are not).

33. Korobkin & Ulen, *supra* note 1, at 1061-62.

34. *See* Klick, *supra* note 6, at 561 n.38.

inconsistent with the predictions, RCT is always flexible enough to allow the theorist to explain the results as consistent with RCT.

On close inspection, when a legal scholar needs to select a set of behavioral assumptions on which to build a normative analysis of legal policy, RCT lacks an obvious a priori advantage relative to BDT. To use a BDT term, only the existence of a status quo bias[35] in the law and economics community—one that that can be overcome only with overwhelming evidence—can explain why RCT-based assumptions should be made the default preference of scholars.

IV. PLAUSIBILITY AND STANDARD FORM CONTRACTS

Rather than relying on possibility stories as a basis for assuming that citizens in law-relevant circumstances behave in accordance with RCT unless and until definitive evidence proves otherwise, I propose that law and economics scholars employ the following test for determining what behavioral assumptions to employ in legal policy analysis: *choose the set of assumptions that is most plausible*. By this, I mean that law and economics scholars should be pragmatic rather than doctrinaire in their choice of behavioral assumptions. We should take into account relevant empirical and experimental data (even when the data is not definitive), less rigorous armchair empiricism in the absence of data vetted by statistical analysis, and the logical implications of both of these data sources. We should then determine what set of behavioral assumptions is most likely to explain behavior in the context of interest to legal policy. That set of assumptions, whether it is more consistent with RCT or findings of BDT research, should then serve as the basis for deriving policy recommendations.

By accepting plausibility as a standard rather than demanding incontrovertible proof, I do not suggest that legal scholars should shrink from developing falsifiable hypotheses and testing them empirically. Rather, I merely recognize the reality that definitive proof will often be unavailable or indeterminate but that the law nonetheless must provide mechanisms by which citizens can order their affairs as best it can.

Turning to the issue of how the law should treat terms in standard form contracts, I contend that my behavioral theory outdistances Klick's in a plausibility competition and, therefore, should serve as the basis for policy analysis unless and until it is supplanted by an even more plausible theory. I believe that Klick's theory, while possible, is quite implausible, and that the questions Klick raises concerning my theory do not undermine its plausibility.

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35. On the status quo bias, see William Samuelson & Richard Zeckhauser, *Status Quo Bias in Decision Making*, 1 J. RISK & UNCERTAINTY 7 (1988); and Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998).

The first hint that Klick's theory is implausible comes from casual empiricism drawn from real-world experience. Most standard form contracts—at least in the consumer context on which both Klick and I focus our attention[36]—are adhesion contracts; that is, they are offered by sellers on a take-it-or-leave-it basis.[37] Klick's price discrimination hypothesis implicitly assumes that sellers agree to redraft or otherwise supplant inefficient, seller-preferred form contract terms when buyers reveal that they are low-time-value types. But in my experience, sellers rarely are willing to haggle over their form terms, no matter how patient the buyer might be. There are some exceptions to this rule, of course; for example, residential real estate contracts might be one. But in the great majority of form-contracting situations, the price discrimination theory is implausible.

The second problem with Klick's hypothesis is that it fails to explain why market competition would not force sellers to offer buyers only efficient contracts. A buyer presented with a set of inefficient, pro-seller terms has two alternatives to accepting the offer: he can negotiate, as Klick's approach assumes, but he also can shop elsewhere. Why will he not choose the latter option? This problem can be solved if we assume that shopping is more costly than bargaining, because this would mean that shopping is always dominated by the two alternative courses of action Klick considers. This move, however, leaves Klick's theory reliant on two somewhat inconsistent assumptions: (1) buyers costlessly learn and understand the terms of one seller's complicated form contract (this is necessary in order for them to determine whether it is worth their time to bargain for better terms); but (2) learning and understanding the terms of a second seller's form contract is prohibitively costly.

Assuming that shopping is more costly than bargaining for buyers, sellers effectively become monopolists, but this leads us to the third and most significant problem with Klick's theory: in most cases, it is not in the interest of rational sellers to use inefficient, pro-seller terms as a price discrimination mechanism. If buyers optimize, as Klick's theory assumes, monopolist sellers can maximize the difference between buyers' willingness to pay (rather than bargain or exit the market) and the costs of production by providing efficient terms and a supracompetitive nominal price. This strategy maximizes the number of buyers who will accept the seller's standard offer and minimizes the number of buyers who will bargain for a better deal.

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36. Klick's hypothesis might be more plausible in business-to-business transactions, in which a seller's standard form is more likely to be a starting point for bargaining than a nonnegotiable offer.

37. *See* Korobkin, *supra* note 10, at 1258.

To bolster his theory, Klick describes a series of empirical examples of price discrimination activities conducted by sellers. Not coincidentally, however, in all of these examples the seller uses nominal price, rather than terms, as the discrimination mechanism.[38] For example, sellers differentiate buyer types by offering lower prices in outlet malls that take more time for buyers to reach than other stores and by offering lower prices to buyers who invest time in clipping coupons.[39] It might make sense to price discriminate with terms under some specific conditions, but the hypothesis is implausible generally because rational sellers usually would use nominal price rather than terms to price discriminate.[40]

Klick raises two challenges to the plausibility of my theory that buyer bounded rationality causes profit-maximizing sellers to seed standard form contracts with seller-preferred nonsalient terms, whether or not these are efficient. First, Klick criticizes an apparent inconsistency in the theory: buyers are assumed to be boundedly rational and, as a result, fail to act in a way that maximizes expected utility, while sellers are assumed to be fully rational profit maximizers.[41] In fact, my theory does not assume that seller rationality is less "bounded" than buyer rationality,[42] only that sellers have access to feedback mechanisms that buyers do not have (a point Klick concedes).[43] No doubt, sellers will often fail to draft the optimal set of contract terms. But, in a competitive market, sellers who fail to provide the profit-maximizing set of contract terms will not be able to compete effectively on price and will lose customers. This market feedback will give them both the information and the incentive to adjust their terms.[44] Buyers lack this degree of feedback and incentive. Most buyers will never know whether a standard form contract to which they are a party contains inefficient terms because they lack access to counterfactual contracts that are economically feasible, and there are no evolutionary pressures that will drive buyers who happen to accept inefficient terms "out of the market" over time.

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38. Klick, supra note 6, at 565 (citing Raymond Chiang & Chester S. Spatt, *Imperfect Price Discrimination and Welfare*, 49 REV. ECON. STUD. 155 (1982)).

39. *Id.*

40. *See* Korobkin, *supra* note 10, at 1211-12 (providing a more complete explanation); *see also* Craswell, *supra* note 7, at 372; R. Ted Cruz & Jeffrey J. Hinck, *Not My Brother's Keeper: The Inability of an Informed Minority to Correct for Imperfect Information*, 47 HASTINGS L.J. 635, 638 (1996); Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, with Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 607-08 (1982); Posner, *supra* note 23, at 843; George L. Priest, *A Theory of the Consumer Product Warranty*, 90 YALE L.J. 1297, 1321 (1981).

41. Klick, *supra* note 6, at 561.

42. Korobkin, *supra* note 10, at 1289.

43. Klick, *supra* note 6, at 561-62.

44. Korobkin, *supra* note 10, at 1219 n.53.

Second, Klick suggests that form terms that are at one point in time nonsalient to a buyer will become salient when a low-probability event occurs (such as a product failure that leads to a dispute), which effectively forces the buyer to become more familiar with the contract's fine print, in turn suggesting that sellers' incentives to draft inefficient pro-seller terms will be constrained by reputational consequences.[45] I agree with Klick's point—that is, I believe that fear of the reputational costs associated with angry buyers will mitigate the market incentive sellers face to draft pro-seller terms whether or not they are efficient—but I do not believe that this point is inconsistent with the theory I propose. Although reputational costs mitigate sellers' incentives, they do not completely eliminate them. Because form contracts usually become relevant only when a low-probability event occurs, there is no reason to believe nonsalient terms will become salient to most buyers. In addition, there is likely to be an adverse selection problem: If buyers who complain about the seller's wares—and, in so doing, have occasion to become aware of the contents of the form terms—are less profitable to sellers than other buyers (because they are the type of buyers more likely to seek refunds, repairs or replacements, litigate, and so on), sellers might have an additional incentive to draft abusive terms in an effort to avoid the future business of this troublesome customer group.[46]

As briefly described above, my argument is based on the following (abbreviated) chain of reasoning:

> (1) empirical evidence suggests that buyers will implicitly price only a subset of product attributes when making purchase decisions;
>
> (2) contract terms are product attributes;
>
> (3) contract terms will often be "nonsalient" (that is, not priced);
>
> (4) sellers will face market pressure to skimp on nonsalient atributes, whether or not this is efficient, in order to have more resources to expend on making salient attributes attractive (such as keeping prices low);
>
> (5) one-sided terms will become salient to some buyers with experience, thus mitigating this incentive, but not to most, thus not eliminating the incentive.[47]

There is no empirical data relevant to parts (2) through (5) of this reasoning. But this should not be the test of the theory's acceptance. The appropriate question is whether my account is more plausible than the alternatives, such as the traditional RCT account that cognitive capabilities are infinite so market pressure ensures all form

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45. Klick, *supra* note 6, at 562.
46. *See* Korobkin, *supra* note 10, at 1240-41.
47. *See id. passim*.

contract terms are efficient or Klick's theory that sellers use inefficient, pro-seller terms as a price discrimination tool. The most plausible account should be used as the behavioral basis for debates on how the law should treat standard form contracts.

V. CONCLUSION

The core insights of law and economics analysis, in my opinion, are that people respond to incentives, that the law can thus affect behavior, and that, therefore, law has efficiency as well as distributive consequences.[48] None of these core insights are conditioned on the assumption that citizens subject to the law always act in a way that is consistent with RCT. Law and economics analysis requires assumptions about behavior, but they need not be RCT assumptions.

The effectiveness of legal policy prescriptions depends on the accuracy of the behavioral assumptions that underlie them, which means we should use scientific methods to test our behavioral assumptions concerning law-relevant circumstances whenever possible. But the law must act; it cannot wait for empirical certainty. So, in many—perhaps most—cases, our touchstone must be plausibility.

48. *See* Korobkin & Ulen, *supra* note 1, at 1054.