

American Law & Economics Association Annual Meetings

Year 2004

Paper 22

Legal Ignorance and Information-Forcing Rules

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LEGAL IGNORANCE AND INFORMATION-FORCING RULES

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People are often ignorant about the legal rules that govern the most common transactions in their lives.¹ Whether purchasing products and services, leasing real estate, obtaining credit, or finding employment, lay people seem to have a fairly poor grasp of even the most basic legal principles. Of course, our ignorance usually causes no harm. We buy what we need, pay back our loans, and work until retirement without becoming embroiled in a legal dispute. But sometimes parties involved in conflicts over defective products, loan

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

defaults, or employment terminations must assert legal rights or defenses, and some of them ultimately resort to litigation. In these circumstances, it is undeniable that having too little legal knowledge can hurt you. Legal ignorance potentially distorts important economic decisions, leading consumers to purchase unreliable or unsafe products, borrowers to accept harsh credit terms, or employees to rely on illusory promises of job security.

This article analyzes one regulatory response to our widespread legal ignorance. It explores how the law encourages legally sophisticated parties to provide legal information to the comparatively poorly informed individuals with whom they do business. I begin by introducing the concept of an “information-forcing” default rule. Then I show how that concept applies to the problem of legal ignorance.² The remainder of the article explores a variety of theoretical and empirical difficulties that afflict the use of information-forcing rules to dispel legal ignorance.

I. THE PERVASIVENESS OF INFORMATION-FORCING JUSTIFICATIONS

In this Part, I explain the origins of information-forcing contract default rules, extend the basic theory to encompass problems of legal ignorance, and illustrate how pervasively courts and legislatures have embraced information-forcing arguments.

A. Origins

So what precisely is an information-forcing rule? As I will use the term, it is any contract default rule that favors one party in order to induce the other party to a transaction to disclose particular information. If the disfavored party fails to provide the targeted information, then that party suffers a legal disadvantage associated with the unfavorable default rule. By providing legally adequate

² For an earlier suggestion that certain employment contract doctrines might serve an information-forcing function, see J. Houtt Verkerke, *An Empirical Perspective Employment Contract Practices: Resolving the Just Cause Debate*, 1995 WISC. L. REV. 837, ____.

disclosure to a transactional partner, however, the party may escape the undesirable default. This definition thus excludes any law that requires a party to disclose specific information and imposes civil or criminal penalties for nondisclosure.³ Such affirmative disclosure duties serve a similar purpose, but operate through a different mechanism. My focus here is on situations in which disclosing parties may opt into different and more favorable rules by providing the required information to their transactional partner. As we will see, even this definition embraces a plethora of judge-made and legislatively enacted rules found in diverse substantive areas of law.⁴

Although the rules themselves have been around for a long time, academic attention to the theory of information-forcing rules originated among economically oriented commentators examining what is now one of the most thoroughly debated contract doctrines—the foreseeability limitation on consequential damages.⁵ Among contemporary contracts scholars, the canonical justification for limiting the recovery of consequential damages to those that are foreseeable in the ordinary course of business is an information-forcing rationale.⁶ According to this approach, courts presume that both parties know the ordinary damages that will flow from a breach of contract. If, however, “special circumstances” will produce greater than ordinary damages, then the party who knows those circumstances must share that information with the other party prior to contracting. Only after obtaining at least implied consent to bear this additional risk can the better-informed party hope to recover for more than ordinary losses in the event of a contract breach.⁷ Thus, a

³ Examples of direct disclosure duties include SEC prospectus requirements, FDA food labeling regulations, and ERISA’s rules requiring plan sponsors to provide summary plan descriptions to participants.

⁴ See *infra* text accompanying notes ___-___.

⁵ For the rule, see *Hadley v. Baxendale*, 156 Eng. Rep. 145 (Court of Exchequer, 1854). For the debate, see, e.g., Ayres & Gertner; Jason Johnston, *Strategic Bargaining and the Economic Theory of Contract Default Rules*, 100 *YALE L.J.* 615 (1990); Barry Adler; others.

⁶ See Ayres & Gertner, *supra* note 4.

⁷ See *Victoria Laundry, UCC*, and *Restatement*.

default rule of limited liability forces one party to reveal information that he or she would rather not disclose.

A considerable literature has explored a variety of difficulties, qualifications, and limitations of this information-forcing rationale for a default rule limiting consequential damages. For example, the “special circumstances” that a party must disclose before contracting may simultaneously reveal important private information about the value of the contract to that party.⁸ Someone who informs a prospective contractual partner that a breach will cause unusually large lost profits has also signaled that he or she may be willing to pay an unusually high price for performance. Ordinarily, competition can be expected to drive the contract asking price down to the cost of providing the relevant goods or services plus the cost of bearing any unusual risk of loss from breach. In imperfectly competitive markets, however, these competing strategic considerations discourage disclosure and may diminish the effectiveness of an information-forcing rule.⁹

Of course, the information-forcing argument for limited consequential damages is but a specific application of a more general principle of comparative advantage.¹⁰ Efficiency-minded courts and commentators select contract default rules by asking which party can more cheaply perform or bear particular risks of nonperformance. The information-forcing argument extends this basic notion of comparative advantage and considers which party is in the best position to disclose information relevant to the transaction. In the context of consequential damages, it is information about factual circumstances such as expected lost profits or alternative sources of supply that the rule encourages one party to disclose. As we will see in the next section, however, information about the legal rules that govern a transaction can also be the object of information-forcing rules.

⁸ See Johnston, *supra* note 4.

⁹ See *id.* at ____.

¹⁰ See Goetz & Scott, *Mitigation Principle*.

B. Information-Forcing Theory Applied to Legal Ignorance

The hoary maxim “ignorance of the law is no excuse” expresses a strong presumption that individuals are adequately informed about prevailing legal rules.¹¹ Whether or not that presumption is justified in the criminal context from which it arises, abundant empirical evidence reveals widespread ignorance about many aspects of civil law.¹² People often lack basic information about the legal rules governing particular transactions in which they are routinely involved. Ignorance about product warranties, termination standards, damage limitations, and the like potentially distort important economic decisions and could produce serious allocative inefficiency.

The argument for information-forcing default rules suggests a possible solution to this problem of legal ignorance. We could treat legal information just as we do information about the expected consequential damages resulting from a breach of contract. Courts or legislatures could determine whether one party has a comparative advantage in obtaining and communicating information about the prevailing law. If so, an information-forcing rule would force the comparatively better informed party either to reveal the relevant legal information or to accept a default rule that favors the less informed party.

A surprisingly large number of common law and statutory rules take this form.¹³ They seem designed to force a legally sophisticated party to inform unsophisticated parties about the prevailing legal standard. Judicial opinions and legislation often make this

¹¹ [cite source]

¹² See Ellickson, *supra* note 1, [and other sources such as Austin Sarat, Support for the Legal System: An Analysis of Knowledge, Attitude and Behavior, 3 Am. Pol. Q. 1 (1975) and Michigan Law Review study on legal knowledge].

¹³ See *infra* text accompanying notes ____-____.

information-forcing objective explicit.¹⁴ For other rules, however, an implicit information-forcing rationale is the most plausible explanation for their structure.

All of these rules share two common characteristics. First, they are default rules in the sense that it is possible to provide the relevant legal information and thus avoid the unfavorable rule that would apply in the absence of this disclosure. Second, the best evidence that a rule's primary purpose is to encourage one party to provide legal information to another is the empirical observation that the overwhelming majority of legally sophisticated parties choose to contract around it. Of course, a court might create such a rule in an unsuccessful attempt to identify a majoritarian default.¹⁵ However, a more plausible—and more charitable—explanation for default rules subject to routine opt-outs is that these rules aim, at least implicitly, to increase the amount of legal information contained in this type of contract.

As we saw earlier, the conventional information-forcing argument for a default rule limiting consequential damages must confront parties' legitimate strategic objections to revealing the value of performance to prospective contractual partners.¹⁶ There is, however, no basis for arguing that one party to a transaction has a right to conceal the prevailing legal rules as legitimately private information. Thus, the argument for legal-information-forcing rules faces one less obstacle. A critic who sought to encourage self-reliance would perhaps contend that a principle of *caveat emptor* should shield parties from any duty to inform their contractual partners about the law. However, such an argument seeks not to conceal the relevant information but instead to encourage uninformed parties to discover it in a different way. An objection on these grounds requires us to compare alternative means of

¹⁴ See, e.g., employment contract cases inviting waiver or disclaimers, ERISA cases on modifying welfare benefits, UCC rules for disclaiming implied warranties.

¹⁵ For discussion of majoritarian default rules, see generally, Goetz & Scott.

¹⁶ See *supra* text accompanying notes 7-8.

conveying legal information but does not call into question the advisability of making this information available at all.

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

C. Some Examples

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

Consider first the legal rules that determine the terms governing discharge from employment. Although the default rule in all but one U.S. jurisdiction is employment at-will,¹⁷ the willingness of courts to enforce implied agreements for just-cause protection strongly encourages employers to contract expressly for an at-will relationship.¹⁸ In fact, many judicial decisions expressly invite employers to contract around the courts' liberal construction of

¹⁷ [cite source]

¹⁸ See Verkerke, *supra* note ____, at ____.

employee handbooks and other informal assurances.¹⁹ Moreover, most courts appear willing, even eager, to enforce express at-will terms so long as they are phrased clearly and positioned prominently among the documents presented to new employees at the time of hiring.²⁰ These doctrines thus satisfy the first requirement for information-forcing rules—they are default rules subject to opt-out.

They satisfy the second criterion as well. Empirical evidence of employment contract practices confirms that the majority of legally sophisticated parties contract expressly for an at-will relationship. Most employers, and especially larger more sophisticated firms, use written confirmations of at-will status.²¹ Because the prevailing default rule is employment-at-will, these express terms are formally superfluous. Nevertheless, such provisions have practical value because they tend to inoculate employers against implied contract claims. The express terms ordinarily take precedence over arguments that written and oral statements can be understood to imply a commitment to provide just-cause protection to employees.

Implied contract doctrine thus serves a legal-information-forcing function. Courts reason that employers should be bound to a just-cause contract whenever assurances or policies concerning job security would lead a reasonable employee to believe that he had some protection against arbitrary discharge. Just as readily, however, they enforce formal disclaimers and confirmations of at-will status contained in employee handbooks and on separate forms signed at hiring. Judges assert that employees who have read or signed such statements must now understand their unprotected legal status.²² By opting out of the implied contract doctrine, employers have thus provided what courts evidently consider valuable legal information. Workers presumably learn the true nature of the legal terms governing discharge from employment.

¹⁹ See, e.g., *Toussaint v. Blue Cross & Blue Shield*; *Wooley v. Hoffman La Roche*.

²⁰ See, e.g., [case example].

²¹ See *Verkerke*, *supra* note ____, at ____.

²² [Quotes from *Wooley*; *Rowe v. Montgomery Ward*; *Toussaint*; others]

ERISA case law similarly includes numerous instances in which a plan sponsor must include specific contract language in order to avoid an unfavorable construction of its benefit plan. The Supreme Court's decision in *Firestone Tire & Rubber v. Bruch*,²³ for example, attaches talismanic significance to highly specific terms found in the formal plan. The Court opines that if, and only if, the employer includes language giving the plan administrator discretionary authority to interpret and construe the plan, then the administrator's decisions to deny benefits should be reviewed using a deferential "arbitrary and capricious" standard. However, if the magical language is not present, then courts are to conduct a *de novo* review of all benefit denials. Predictably, employers have responded to this ruling by amending their plans to include this language.

In this case, the Court never specifically invokes an information-forcing rationale for its rule.²⁴ Instead, Justice O'Connor's opinion relies on formal doctrinal rules from the law of trusts. Although this formal doctrinal analysis has been subject to withering criticism,²⁵ an alternative justification for the Court's ruling is that plan participants and beneficiaries should have some way of knowing what standard of review will apply to their disputes with plan administrators. The language required by *Firestone* thus might alert individuals that their plan administrator has significant discretion over benefit payments. The rule establishing *de novo* review as the default clearly permits opt-outs, and virtually every plan now expressly grants the administrator discretionary authority to interpret and construe the terms of the plan. In functional terms, the *Firestone* rule appears to be a pure legal-information-forcing rule.

Other ERISA rules reveal a similar pattern. In some circuits at least, a default rule restricts a plan sponsor's right to make unilateral changes to the terms of the plan. However, plans routinely include

²³ 489 U.S. 101 (1989).

²⁴ [check carefully to make certain of this point]

²⁵ See Langbein, *Flunks Trusts*.

express language permitting amendment or termination of the plan.²⁶ The default rule thus has no practical effect other than inducing plan sponsors to provide information about the legal rule governing plan modifications.

At a more pedestrian level, lower court cases interpreting ERISA's requirement of a summary plan description (SPD) impose several contradictory standards that are curiously unified by their confident reliance on the informative value of express contract terms. Cases falling at one end of the spectrum require employers to include in the SPD extremely specific legal facts concerning the circumstances that might lead to a benefit denial.²⁷ Employers who fail to provide this legal information risk having to pay benefits to participants to which they would not be entitled under the terms of the formal plan. In contrast, other cases give employers much wider latitude to omit information from the SPD so long as the SPD includes an express disclaimer directing beneficiaries to consult the formal plan documents to determine their rights and obligations.²⁸ In both of these cases, the default rule formally favors employees but seems designed solely to induce employers to include certain legal information in their SPD. Once again, the universal practice of plan sponsors is to opt out of the default by providing the required information.

Legal-information-forcing rules are equally common outside of the employment context. Recall, for example, your last skydiving or hang-gliding lesson. Or think about the documents you signed before participating in a whitewater rafting adventure or when you registered your child to play soccer or lacrosse. In each of these cases, the activity sponsor faces potential tort liability for any negligently caused injuries to participants. However, courts

²⁶ See *Sprague v. General Motors* (enforcing right to modify despite seemingly contradictory language in many plan summaries).

²⁷ See, e.g., *Ruotolo v. Sherwin-Williams Co.*, 622 F. Supp. 546 (1985); *Zittrouer v. Uarco Inc. Group Benefit Plan*, 582 F. Supp. 1471 (N.D. Ga. 1984).

²⁸ See *Kolentus v. Avco Corp.*, 798 F.2d 949 (7th Cir. 1986), *cert. denied*, 479 U.S. 1032 (1987).

routinely give effect to prospective waivers of liability for ordinary negligence.²⁹ The barrage of exculpatory clauses that greet participants in these activities is the predictable consequence of these rules. Such waivers have the practical effect of converting the ostensibly mandatory tort rule into an information-forcing default.

Similarly, the UCC contemplates—and product manufacturers routinely invoke—an express formula for disclaiming the Code’s default warranty of merchantability and limiting consequential damages.³⁰ Credit card agreements include a variety of exculpatory clauses designed to protect the credit card issuer from liability for its refusal to authorize a particular credit transaction.³¹ Contracts for services such as car rental agreements contain a host of clauses that place responsibility for certain losses on the rental customer and excuse the rental company from liability.³² Computer software end-user license agreements (EULA) include comprehensive disclaimers of virtually every form of liability that might be imposed on the software publisher and strictly limit the purchaser to the remedy of replacing defective disks.³³ Software downloaded from the Web similarly requires prior consent to a “click-wrap” license that contains the familiar litany of exculpatory clauses.³⁴ Finally, online communities and Web-based services demand that participants agree to an exhaustive list of liability limitations and service restrictions.³⁵

The common thread that runs through all of these examples is that sophisticated contracting parties respond to rules favoring their contractual partners by adopting express terms that shift the balance of legal rights in their own favor. Naïve default rule analysis would

²⁹ A few states, including Virginia, refuse to enforce prospective waivers for team sports. Most other states distinguish ordinary from gross negligence. Waivers protect against liability for ordinary negligence but remain ineffective against gross negligence.

³⁰ See [UCC §§ 2-316, 2-719].

³¹ See [example from case].

³² See [example].

³³ See [find sample license].

³⁴ See [example of Microsoft Windows Update].

³⁵ See [example of AnyDay.com].

criticize these doctrines for generating unnecessary transaction costs. On this view, the rules cause wasteful efforts to draft disclaimers, liability limitations, and other exculpatory clauses that appear in virtually every contract. The theory of information-forcing defaults provides an alternative, more constructive role for these doctrines. According to this perspective, the routine practice of contracting around such rules conveys valuable legal information to comparatively unsophisticated parties. It remains to be seen, however, how well express contract terms serve that function.

II. THE PROBLEM WITH INFORMATION-FORCING JUSTIFICATIONS

In this Part, I identify a significant practical problem with legal-information-forcing rules that allows legal ignorance to persist even in the face of fully informative express contract terms. Scholars, and to a lesser extent judges, have considered this problem, but their analysis does little to clarify the appropriate scope or design of these rules. One possible response to these shortcomings would be to design more effective ways to convey legal information to unsophisticated parties. I argue, however, that we currently lack essential empirical facts about how people obtain and process legal information.

A. The Persistence of Legal Ignorance

As the previous section demonstrated, we receive an extraordinary quantity of legal information in our ordinary lives as employees and consumers. In light of the ubiquity of express contract terms, it is nothing short of remarkable how little we seem to know about the law governing our diverse transactions. But a moment's introspection reveals a straightforward explanation for this divergence between the quantity of information provided and level of legal understanding achieved. A major premise underlying the argument for legal-information-forcing rules is almost certainly false. To put the matter most simply, people most often ignore the text of written contracts. Almost no one reads contracts carefully

enough to digest the legal information that these default rules are designed to force.³⁶ Thus, if the purpose of these doctrines is to convey legal information to all, or even many, unsophisticated parties, that objective is likely to be frustrated.

B. Judicial and Scholarly Perspectives on Legal Ignorance

Several strands of the scholarly literature bear some relation to the problems we have been considering. First, a substantial body of work explores the potential benefits of imposing legal disclosure requirements in various transactional settings. For example, federal law requires lenders to disclose repayment terms and annual percentage rates in a standardized format.³⁷ Similarly, food and drug law requires product labels to include ingredient lists and nutritional information.³⁸ And securities law mandates that issuers publish a comprehensive prospectus describing any new offering in excruciating detail.³⁹

Considerable effort has gone into evaluating the success or failure of particular disclosure obligations. An early article by William Whitford, for example, reviews studies of how truth-in-lending laws affect consumer knowledge of credit terms.⁴⁰ More recently, commentators have argued that excessive disclosure requirements create a danger of information overload.⁴¹ Still other work relies on experimental studies of consumer behavior to challenge the information-overload hypothesis.⁴² These papers show that consumer search strategies readily adapt to the presence of too

³⁶ See [Michigan survey; plain language study].

³⁷ See [Truth in Lending statements required by FTC].

³⁸ See [FDA regs].

³⁹ See [SEC regs].

⁴⁰ William C. Whitford, *The Functions of Disclosure Regulation in Consumer Transactions*, 1973 WISC. L. REV. 400.

⁴¹ See [sources cited in Schwartz & Wilde].

⁴² David M. Grether, Alan Schwartz & Louis L. Wilde, *The Irrelevance of Information Overload: An Analysis of Search and Disclosure*, 59 S. CAL. L. REV. 277 (1986).

much information by simply ignoring the excess. As a result, excessive disclosure may well be worthless, but it does not cause consumers to make poor choices as a result of an “overload” of information.⁴³

This disclosure literature may provide useful insights into consumers’ information processing techniques. However, disclosure regulations and information-forcing defaults differ in important respects. The sanction for violating disclosure rules is typically a civil or criminal penalty of some kind. In contrast, a party who fails to provide the information targeted by an information-forcing default must carry out the transaction under an unfavorable legal rule. The most appropriate remedy for excessive disclosure regulations is simply to eliminate the unproductive requirements. Fixing a malfunctioning information-forcing default requires a lawmaker to determine an appropriate legal rule to govern the transaction in question. Finally, disclosure regulations often specify with great precision what and how parties must make required disclosures. Information-forcing defaults are ordinarily cast in more general terms and leave much to the discretion of the disclosing party.⁴⁴ This lack of standardization significantly complicates the task of evaluating the effectiveness of a legal-information-forcing default rule.

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

⁴³ *Id.* at ____.

⁴⁴ See, e.g., [example of employment contract disclaimers and confirmations of at-will status].

been the subject of frequent academic criticism.⁴⁵ Although judges express occasional misgivings about enforcing form contracts, courts have largely ignored the most extreme academic critics who would, for example, create a presumption against enforceability.⁴⁶ Instead, prevailing law enforces unfavorable form contract terms against unsophisticated parties so long as they meet minimal standards of procedural fairness.⁴⁷ Judges appear to assume implicitly that adhering parties are either adequately informed about the terms of their agreement or that a competitive market provides sufficient protection against fundamentally unfair agreements.⁴⁸ On those few occasions that courts refuse enforcement they invariably find that a particular clause is both substantively oppressive and that the process of agreement was flawed in some way.⁴⁹

No similar problems afflict the express terms that are the subject of this article. Although the terms with which we are concerned almost always appear in standard form contracts, few if any of them are even arguably unconscionable. Indeed, numerous judicial decisions invite employers or other sophisticated parties to contract expressly to avoid the unfavorable consequences of the default rule.⁵⁰ It would be utterly incongruous to invite parties to contract around an information-forcing default rule only to rule subsequently that those very terms were unconscionable. Moreover, courts have shown little sympathy for litigants who claim not to have read or understood provisions of the legal documents they have signed.⁵¹ The “duty to read” doctrine creates a virtually irrebuttable

⁴⁵ See Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943); Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174 (1983).

⁴⁶ See Rakoff, *supra* note ____, at ____.

⁴⁷ See [citation].

⁴⁸ See, e.g., [case examples of both arguments].

⁴⁹ See [California unconscionability doctrine].

⁵⁰ See [handbook cases, ERISA cases, insurance cases, UCC warranty doctrine].

⁵¹ See [duty to read cases].

presumption that a person is fully aware of the contents of any writing that he or she has signed.⁵² With the exception of cases involving potential fraud or misrepresentation, courts thus stand ready to enforce the express contract terms that legal-information-forcing rules cause sophisticated parties to include in their agreements.

Recent academic commentary lauds the potential utility of legal-information-forcing default rules. My own prior work on employment contract practices first suggested an information-forcing rationale for rules that liberally construe informal assurances of job security against employers.⁵³ In a more recent article, Cass Sunstein has embraced the information-forcing theory as a general argument for switching default rules to favor employees.⁵⁴ One common characteristic of all conventional information-forcing arguments is that they rely on an assumption that the targeted information will be received and understood.

Despite the myriad information-forcing default rules currently in effect, however, legal ignorance persists. Existing doctrines cause contracts to include copious quantities of legal information. However, neither courts nor commentators appear to have given much thought to the question of whether these express terms serve their ostensible purpose of informing parties about the legal rules governing the transaction. Thus one possible response to the persistence of legal ignorance would be to improve the quality of existing legal disclosures. Lawmakers might try to design information-forcing rules that induce sophisticated parties to provide legal information in a manner that is more likely to be read and understood. The next section reviews the surprisingly sparse research available on this issue and speculates about the feasibility of perfecting the informative function of information-forcing rules.

⁵² For a typical application of this doctrine, see *Reid v. Sears Roebuck*.

⁵³ See Verkerke, *supra* note ___, at ___.

⁵⁴ Cass Sunstein, *Switching Default Rules*.



C. Designing Effective Express Contract Terms

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

[Discuss plain language movement for form contracts.]

A survey of unemployment insurance applicants conducted by Pauline Kim provides suggestive evidence that individuals' beliefs about job security are unresponsive to commonly used confirmations of at-will status.⁵⁵ One problem with her survey design is that she asked subjects about specific scenarios before introducing the at-will language and then asking the same subjects about the same scenarios. A conditioning effect could explain why subjects answered the same questions in the same way the second time around. A better experimental design would have used separate treatment and control groups to determine the effect of at-will language on subjects' beliefs about job security.

More recent work by Jesse Rudy improves on Kim's study by surveying employed individuals rather than those who have recently lost their jobs.⁵⁶ Rudy largely confirms Kim's findings about workers' tendency to overestimate the legal protections against discharge that they enjoy. Because he chose to administer a survey instrument identical to the one Kim employed, his replication of her results showing the ineffectiveness of at-will language is subject to the same criticism. Nevertheless, these results are currently the best available evidence that legal-information-forcing rules relating to employment termination may fail to inform workers about the law.

⁵⁵ Pauline Kim, *Bargaining with Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105 (1997).

⁵⁶ Jesse Rudy, *What The Don't Know Won't Hurt Them: Defending Employment-At-Will in Light of Findings that Employees Believe They Possess Just Cause Protection*, 23 BERK. J. EMPLOY. & LAB. L. 307 (2002).

As Jesse Rudy suggests, workers might well be rationally ignorant about the legal terms governing employment termination.⁵⁷ The expected cost of acquiring this legal knowledge may exceed the expected benefit that such knowledge could confer. Perhaps there exists no feasible method of communicating contract terms that would inform workers about the prevailing legal rule governing discharge.

If this speculation is correct, we must entertain the possibility that for some legal rules the broad information-forcing objective is futile. It may be simply impossible to design legal requirements for contracting out of these rules that will allow the majority of unsophisticated parties to receive and process the relevant information. Kim's and Rudy's work hints that this may be true for terms governing discharge from employment. We might expect similar problems to arise in other legally complex areas such as ERISA benefits, warranty disclaimers, damage limitations, and insurance contracts.

III. ALTERNATIVE RATIONALES FOR INFORMATION-FORCING RULES

We have seen that legal-information-forcing rules may well fail to inform the majority of unsophisticated people about the legal rules governing their transactions. Accordingly, it is important to explore alternative purposes that such rules might serve. This part examines three possibilities. First, the express terms that result from information-forcing default rules might improve the accessibility of legal information for a small minority of diligent comparison shoppers. Second, those terms could facilitate *ex post* dispute resolution by providing a clear statement of the legal rules governing each transaction. Finally, we might understand exculpatory contract language as an effort to opt out of the comparatively expensive legal system in favor of an alternative regime of rights and obligations enforced solely by informal social norms.

⁵⁷ Id. at ____.



A. Inform Comparison Shoppers

The conventional understanding of information-forcing rules dictates that the resulting communications should inform all, or at least most, of the uninformed parties about the targeted information. Even if most people ignore the terms of written contracts that they sign, however, it is nevertheless possible that those terms provide valuable information to a smaller group of parties. Express contract terms significantly lower the cost of information for avid comparison shoppers who are willing to invest in learning the legal details surrounding a transaction.

An often-cited article by Alan Schwartz and Louis Wilde argues that competition among producers to serve well-informed comparison shoppers provides benefits to all other consumers.⁵⁸ Legal-information-forcing defaults ensure that critical information about the legal rules governing each transaction is readily accessible in the written documents for that transaction. On this interpretation, the default rule facilitates comparison shopping. The activities of comparison shoppers in turn promote allocative efficiency by scrutinizing the proffered terms and exerting some pressure on employers, manufacturers, and service providers to offer a more balanced and reasonable set of terms than they would otherwise be inclined to draft.⁵⁹

One significant weakness of the comparison shopping rationale is that it depends on the availability of diverse choices in the relevant marketplace. If all sellers or employers offer an identical package of express contract terms, then comparison shoppers can expect no benefit from their investment in legal knowledge. In these circumstances, it seems doubtful that any individuals will bother to acquire the legal information that these express terms convey. For example, standard form insurance contracts vary so little among

⁵⁸ Alan Schwartz and Louis Wilde, *Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis*, 127 U. PA. L. REV. 630 (1979).

⁵⁹ *Id.* at ____ - ____.

insurers that even avid comparison shoppers might rationally focus their search exclusively on variable parameters such as price and coverage limits.

A second related problem with this justification for information-forcing rules is that individual consumers or workers may face too few choices to make comparison shopping worthwhile. In recessionary times, workers often feel compelled to accept the first job offer that they receive. Uncertainty about their chances of receiving a competing offer coupled with the financial and emotional stress associated with continued unemployment sometimes rules out shopping behavior on the part of job seekers. Similarly, transportation costs or other factors creating a local monopoly could make consumer choices equally constrained. In these circumstances, the goal of informing comparison shoppers falls short of justifying the use of information-forcing default rules.

B. Ex Post Legal Clarity

Alternatively, express terms may be desirable not because they inform people about the prevailing legal rule *ex ante* but instead because they make the rules clear *ex post*. Greater clarity *ex post* reduces the cost and uncertainty surrounding both settlement negotiations and adjudication. On this account, legal-information-forcing rules provide no direct benefit for the unsophisticated parties to whom the resulting express contract terms are proffered. These parties benefit only indirectly from the fact that expected litigation costs are reduced by the clarity those terms provide. One can easily imagine that over-burdened courts might also be sympathetic to contract practices that facilitate settlement or summary disposition of potential legal disputes. Express terms preclude some litigation entirely by specifying the parties' legal rights, or lack of legal rights, clearly and precisely. For cases that find their way into the judicial system, those same terms give judges grounds to dismiss complaints or grant summary judgment whenever the express terms resolve the dispute.

One bit of evidence tends to confirm the relevance of this rationale. Legal-information-forcing rules most often apply to

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

Nevertheless, courts often seem to make contract interpretation more complicated and uncertain than absolutely necessary.⁶⁰ Additional social goals such as substantive or procedural fairness thus must qualify the objective of *ex post* legal clarity. Moreover, an account of information-forcing rules ideally should incorporate a plausible account of what motivates the behavior of contracting parties. Focusing too much on judicial objectives could distort our picture of the role that express terms play in the relations between contracting parties.

C. Opting for Norms Rather Than Law

A third rationale for express contract terms focuses on informal alternatives to the legal system. Under this approach, a thoroughly exculpatory express contract simply confers legal discretion on the sophisticated party to administer a norms-based claims settlement procedure without undue interference from the more costly and cumbersome legal system. Information-forcing default rules effectively allow sophisticated parties to opt out of the legal system. In the place of legally enforceable rights, these parties offer their contractual partners a system of social norms. To the extent that

⁶⁰ See [UCC stance on contextual evidence, insurance contract cases].

they choose to enforce exculpatory contract language, courts accept this substitution of social norms for legal rights.

Not surprisingly, there are limits to the willingness of courts to cede authority over resolving disputes and establishing principles of responsibility. On this interpretation, doctrines such as unconscionability, duress, and misrepresentation allow courts to intervene selectively when they become convinced that a sophisticated party has abused its power. Nevertheless, contract drafters retain considerable discretion to preclude employees and consumers from resorting to legal processes. Within this broad domain, legal-information-forcing rules ironically allow private parties to displace legal rights altogether and substitute a system governed primarily by informal social norms.

Somewhat analogously, arbitration clauses are designed to reduce forum costs. As compared to the exculpatory clauses we have been considering, arbitration preserves more fully parties' legal rights.⁶¹ However, the impulse underlying arbitration clauses closely mirrors the goals that sophisticated parties pursue with the exculpatory contract terms. For this reason, judicial approaches to mandatory pre-dispute arbitration agreements closely parallel their treatment of the exculpatory clauses we have been considering in this section.

D. Some Policy Implications

Both common law and statutory rules may usefully encourage legally sophisticated parties to inform comparatively unsophisticated parties about applicable legal standards. However, courts and legislatures often appear to assume uncritically that unsophisticated parties read and understand formal contract provisions. In fact, parties frequently ignore such provisions entirely.

There are (at least) three defensible responses to this empirical fact (for those situations in which it can be firmly established that most parties ignore express terms.).

⁶¹ See, e.g., *Mitsubishi* (forum selection argument)

First, courts can shape these doctrines to make information-forcing rules more effective. Further empirical evidence could reveal which doctrinal innovations hold the greatest promise for better informing unsophisticated parties. Case law has thus far sought principally to promote greater prominence and clarity of express contract terms in the apparent belief that these characteristics will make such terms more informative.

There is, however, absolutely no empirical basis for determining what will work. Contemporary scholars such as Cass Sunstein somewhat blithely assume that some combination of express terms and disclosures will convey the targeted information. However, introspection and casual empiricism suggest that many—perhaps most—of these clauses go unread. If the problem is that no one reads contracts, then an effective doctrine would have to require parties to read agreements before signing. If, however, lay people are unable to understand agreements even after reading them, then courts might need to require the participation of an attorney when contracts are formed.

The enormous costs associated with these approaches should make us cautious to embrace them. If, for example, efficiency only requires that avid comparison shoppers read written agreements, then it would be extremely wasteful to impose costly duties that apply to every transaction. However, if the social goal is to affect each individual's beliefs and behavior, then lawmakers should develop some firm empirical basis for believing that particular forms of regulation will be effective.

Alternatively, courts could abandon the pretense that formal terms inform unsophisticated parties and embrace a new rationale for these requirements. Perhaps unsophisticated parties are rationally ignorant about express contract terms. The cost of reading and understanding contractual terms may exceed the expected value of being better informed about the prevailing law. Parties thus may prefer to rely on informal mechanisms of contract enforcement. If so, then efforts to force them to become aware of the terms governing each transaction are socially wasteful.

Courts might nevertheless encourage sophisticated parties to draft express terms when that practice makes sense for other reasons. For example, comprehensive express terms could make legal rules clear *ex post*. Such an objective implies very different priorities for regulating the content of contracts. We would worry far less about prominence and the contracting process and focus almost exclusively on requiring clarity in the terms themselves in order to eliminate any possible ambiguity.

Of course, if no persuasive argument exists for continuing to encourage express terms, courts should perhaps abandon legal-information-forcing rules entirely. One final possibility is that courts may be unwilling to express the true justification for these rules. For example, it may be difficult for a court to acknowledge that most people derive no benefit from knowing the express terms of their agreements. Thus, the deep justification for these rules might be some combination of the alternative rationales I have explored in this part. Nevertheless, courts continue to rely on the legal fiction that express terms are truly informative.

IV. CONCLUSION

This article has argued that a surprisingly broad range of contract default rules have the ostensible purpose of inducing sophisticated parties to draft express contract language that will inform their contractual partners about the legal rules governing a particular transaction. I have also suggested that this legal-information-forcing objective often founders because people sign contracts without reading and understanding their terms. It is theoretically possible that courts could design information-forcing rules that would be truly informative. However, we currently lack adequate empirical data about how people process legal information to be able to fashion such rules with any confidence.

Recognizing the potential futility of attempts to inform most contracting parties about complex legal rules, I have also explored several alternative justifications for doctrines that encourage sophisticated parties to draft express contract terms. Such terms facilitate the activities of avid comparison shoppers. Comprehensive

written terms also promote *ex post* legal clarity and thereby reduce the costs of resolving disputes. Finally, a litany of exculpatory clauses effectively allows parties to contract out of the comparatively expensive legal system of dispute resolution in favor of a regime governed by informal social norms.

Each of these rationales for express contract terms contains more than a grain of truth. Existing practices seem broadly consistent with the view that all three operate to some extent in the current legal environment. Perhaps the most accurate descriptive story is that an uncertain amalgam of these various objectives motivates the widespread use of legal-information-forcing rules. The normative desirability of these rules is somewhat less clear, but my exploration of alternative justifications shows the conceptual poverty of current judicial and legislative reliance on the informative content of express contract terms. Any successful defense of the existing regime must necessarily venture beyond the conventional understanding of information-forcing rules.

