

**Presentation Proposal**  
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**The Long and Somewhat Winding Road From Disclosure Statutes to a  
Neoclassical Conception of Freedom of Contract**

**Synopsis:** This paper examines the underlying premises of disclosure statutes in the commercial law area. It argues that disclosure statutes are based on several well-established principles of classical contract law, all of which have been called into question, if not serious doubt, by cognitive psychology and behavioral law and economics, among other schools of thought. The obvious implication is that, if the underlying premises for disclosure statutes are questionable, then disclosure statutes will probably not be very effective in achieving their purported objectives. Indeed, early empirical studies of the Truth in Lending Act and the Magnuson-Moss Warranty Act seem to support this hypothesis. Given this preliminary conclusion, the rest of the paper then examines and attempts to explain why we continue to rely on disclosure statutes as a method to correct perceived problems in commercial contracting. It appears that we continue to rely on disclosure statutes instead of, for example, substantive regulation, because we can say that disclosure statutes do work to some extent *and* they have the added benefit of being a corrective mechanism that infringes rather minimally on the parties' freedom of contract. So, by continuing to rely on disclosure statutes we are, in effect, also choosing to privilege a hallmark of the classical conception of contract law, namely, the freedom of contract ideal with its ever present corollary that contracts that are freely entered into should be enforced. The classical ideal of freedom of contract, however, is also premised on the same classical assumptions on which disclosure statutes are based. Therefore, the paper concludes by arguing that absent the classical contract law justifications, the classical freedom to contract ideal does not and cannot exist; and instead, the current "theory of rights based on contract" *looks like* a naked (ab)use of power.

**A Longer Synopsis of the Arguments**

Disclosure statutes have been in use in the United States for decades. These statutes exist, to a large extent in the consumer protection arena (i.e., the Truth in Lending Act and the Magnuson-Moss Warranty Act), but are not limited to this area. For example, several provisions of Article 2 of the Uniform Commercial Code require disclosure, namely, the provisions on good faith, unconscionability and implied warranty, and they apply to merchants as well as consumers. Significantly, we seem to choose disclosure as the method to address certain types of perceived problems in commercial contracting, like bargaining imbalances, for two reasons: first, because we tend to favor process over substantive regulation, and, second, because we still place a lot of credence in the classical conception of contract law. Whether process or substantive regulation of commercial contracting should be the preferred method of resolving market imperfections/problems or bargaining imbalances is a policy choice and is not the focus of this paper. Instead, this paper endeavors to analyze the second part of the disclosure statute rationale, namely that we seem to rely on disclosure statutes, at least in part, because they are supported by well-established principles of classical contract law.

Disclosure statutes are substantive in the following way: we say that *these specific pieces of information* are material and have to be disclosed in *this* manner. Thus, for example, under the Magnuson-Moss Warranty Act, sellers are required to disclose “fully and conspicuously . . . in simple and readily understood language” terms like the commencement and duration of the warranty, the scope of coverage, and the procedures for obtaining warranty service. Notwithstanding this substantive element, disclosure statutes are fundamentally process oriented. The underlying assumption appears to be that if a contracting party gets *these* disclosures in *this manner* then that party will read it, understand it, know what to do with it, *and*, significantly, will make the “correct” decision. The “correct” decision, the decision we are ultimately concerned with is the decision about whether to enter into the contract or not. If that hypothetical contracting party then *chooses* to enter into the contract under these circumstances, we as a society can feel perfectly comfortable with holding *that party* to *that contract*. Disclosure statutes, therefore, seem to be premised on a very classical conception of contract law. That conception presupposes, among other things, that: (a) the parties have relatively equal bargaining power, sophistication *or at least* access to information; (b) individuals act as rational market actors in reaching their contractual decisions; and (c) markets are perfect. Certainly, *if these premises exist/are correct*, then parties should be free to bargain over just about anything they want (the very classical freedom of contract ideal) *and* the law should give their bargain literal effect, that is, protect the parties “justified” expectations based on their contract. This latter statement is, of course, freedom of contract’s well-known corollary, i.e., that contracts should be kept.

The problem, of course, is that *all* of the premises that the classical conception of contract law presuppose are suspect. Some of these premises have been called into serious question by cognitive psychology and the very related school of thought known as behavioral law and economics. Cognitive psychology, for example, has demonstrated that *because their are limits to cognition*, such as “bounded rationality,” “irrational disposition,” and “defective capability,” individuals *do not* act as rational actors in the marketplace. Instead, individuals in the marketplace often act in *irrational* but predictable ways. Building off of this information, behavioral law and economics helps undermine the assumption that markets are perfect by demonstrating that businesses: (a) are actually aware that consumers act irrationally; and (b) intentionally develop and use marketing strategies to manipulate that irrationality, specifically, to manipulate consumers’ risk perceptions. Finally, basic principles of micro-economics inform us that perfect markets, i.e., markets in which there are perfect competition, require very specific characteristics; and in the real world, very few markets actually exhibit the necessary characteristics to be deemed “perfect.”

If the underlying classical contract law premises for disclosure statutes are arguably contestable, because they have been called into serious question/doubt, the obvious implication is that while disclosure statutes may empower certain individuals to achieve positive individual results, they will not be very effective in achieving their purported objectives on a market or industry wide basis. Early empirical studies on the Truth in Lending Act and the Magnuson-Moss Warranty Act seem to bear this conclusion out.

Yet the use of and emphasis on disclosure statutes persist. Indeed, efforts to incorporate

or impose more substantive requirements into commercial statutes and, ultimately, into commercial contracts generally fail, both historically and now. A good example of this is the early attempts to substantively legislate automobile warranties and the failed Model Consumer Credit Act (originally the National Consumer Act). For a more current example, one need only look at the debates and controversy generated by the amendment of Article 2 of the Uniform Commercial Code.

But if disclosure statutes do not work really well in achieving their objectives, why not switch to something else that might work better? One reason is that, while disclosure statutes may not be *completely* effective, they do achieve some positive results, or, more fatalistically, they are better than nothing. Another reason that we rely on disclosure, as opposed to substantive, regulation, is because the alternative is more difficult. For example, any substantive regulation would raise the familiar paternalism argument. Such regulation would also beg the questions--*who* should decide the issue (state or federal legislative bodies) and by what criteria should the substantive limitations be selected? One can also argue, persuasively I think, that resistance to substantive regulation is also premised, *at least* in part, on the freedom to contract ideal. In other words, regulation that imposes substantive limitations on commercial contracts seem to conflict with a fundamental and cherished belief that parties should be free to contract without interference, or with minimal interference, from the state. Disclosure statutes, because they generally do not regulate the substantive terms of contracts, have a much more limited impact on the parties' freedom of contract. So, to answer the question posed at the beginning of this paragraph another way, we continue to rely on disclosure statutes instead of, for example, substantive regulation, because we can say that disclosure statutes do work to some extent *and* they have the added benefit of being a corrective mechanism that infringes rather minimally on freedom of contract.

By continuing to rely on disclosure statutes, therefore, we are, in effect, also choosing to privilege a hallmark of the classical conception of contract law, namely, the freedom of contract ideal *with* its ever present corollary that contracts that are freely entered into *should be enforced*. Evidence exists that the pendulum has swung, and is probably still swinging, back toward this particular "theory of rights based on contracts." Examples that could be cited to support the foregoing proposition include the recent bankruptcy amendments, which make it harder for individuals to get certain kinds of contract-based debt, like credit card debt, discharged, and the Truth in Lending Act amendments, which redefined and limited the consumer's right of rescission.

Of course, this freedom of contract ideal is arguably also premised on the same classical principles of contract law that underlie the preference for disclosure regulation. The problem, then, is that if the premises underlying the classical conception of contract law are questionable, as this paper (and many others) endeavor to show, we do not, and cannot, really have "freedom of contract" as defined or conceptualized by the classical theorists. So, what *do* we have? Arguably, what we have is a conception of freedom of contract as unrestrained power, or at least as unrestrained as possible, which clearly transcends even the classical notions of the freedom of contract ideal. That is, even the classical theorists, like Professor Williston, did not believe that *unlimited* freedom of contract would lead to public or individual welfare. Indeed, freedom of

contract stripped of its underlying classical justifications/premises does not and cannot get us to the corollary that contracts should be kept. In other words, one simply cannot leap from the idea of freedom of contract to the potentially draconian corollary that *contracts should be kept* without some kind of moral, theoretical, and/or political justification. Consequently, absent the classical contract law justifications, the current “theory of rights based on contract” *looks like* a naked (ab)use of power.

Whether one agrees or disagrees with the analysis used and conclusions reached in this paper, the discussion, or even the debate, cannot stop there. If one agrees that the current theory of rights based on K *is* a naked (ab)use of power, then the challenge is to figure out how to “fix it” or at least to begin discussing what a better alternative would or should look like. Would disclosure statutes still have a role to play? Another interesting project would be to analyze who is helped and who is hurt by such a conception of contract/commercial law. If one *disagrees* that the current theory of rights based on K is a naked (ab)use of power, then the challenge is to come up with the moral, theoretical and/or political justifications to explain how we get from a freedom of contract ideal to the corollary that contracts should be kept. Such “neoclassical” justifications would certainly have to respond to the critiques leveled against the classical system. All of these projects are beyond the scope this paper. But I look forward to participating further in what I hope will be an on-going discussion.