Frictions and the Persistence of Inferior Contract Terms

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FRICTIONS AND THE PERSISTENCE OF INFERIOR CONTRACT TERMS

Royce de R. Barondes†

ABSTRACT

A rudimentary conceptualization of the development of ancillary contract terms would assert competition will result in terms that are joint-wealth-maximizing for merchants and customers. Building on developments in modeling frictions in markets, this article presents simple models of frictions in multi-period contracting as to ancillary contract terms. The modeling illustrates that, for plausible parameter estimates of frictions, combinations of switching costs and investigation costs may allow collectively inferior contract terms to persist in consumer transactions. The results are in harmony with recent evidence illustrating the infrequency with which consumers actually read contract terms.

The modeling identifies circumstances where this opportunistic behavior—taking advantage of frictions to secure collectively suboptimal contract terms—is particularly likely. They include: (i) contracts of small dollar amounts, in terms of consideration or marginal cost in rendering performance; (ii) contracting involving the sequencing of relationship-specific investments during formation; (iii) multi-period contracting involving increasing switching costs; (iv) rapidly growing markets; and (v) merchants who bifurcate contractual terms among customers. A number of these factors are common to the provision of online services.

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This article additionally samples authority that can be revived by courts inclined to police opportunistic structuring of the methods of mutual assent to secure collectively suboptimal contract terms.

**INTRODUCTION**

We have all encountered—although perhaps not often actually read—ancillary contract terms that appear unlikely to be designed to be in the aggregate interest of the parties. Illustrative are the facts of a recent case from Missouri, *Whitney v. Alltel Communications, Inc.*, involving a successful challenge to a contract provision that sought to require individual (non-class) arbitration of disputes arising from allegations concerning deceptively unlawful $0.88 monthly charges to phone customers.

Thirty years ago, some Law and Economics scholars claimed market competition would eliminate contract terms that did not maximize the aggregate wealth of the parties: “If one seller offers unattractive terms, a

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1 173 S.W.3d 300 (Mo. Ct. App. 2005).
competing seller, wanting sales for himself, will offer more attractive terms. The process will continue until the terms are optimal.”

Korobkin describes this principle as follows: “[S]tandard law-and-economics reasoning suggests that, if buyers and sellers behave in accordance with assumptions of rational choice theory, the operation of the market usually will provide drafting parties with an incentive to include only efficient terms in form contracts.”

Twenty years later, Posner had retreated from full support of this rudimentary formulation. But the capitulation could not be unequivocal:

But if one seller offers unattractive terms, won’t a competing seller wanting sales for himself, offer more attractive terms, the processing continuing until the terms are optimal? …

All this said, the form contracts used in consumer transactions do tend to be one-sided against the consumer; evidently, competition cannot be relied upon to yield the optimal form…. Competition cannot be relied upon to eliminate this asymmetry because the benefits of the “good” form to the consumer are too slight to overcome the information costs of making those benefits an effective selling point.…

Yet the one-sided form contract may be optimal after all. A seller is more likely to be deterred from behaving opportunistically by considerations of reputation than a consumer is…. Slanting the terms of the contract in favor of the seller is a way of redressing the balance. The existence of a one-sided contract does not mean that the transaction will necessarily be one-sided, but only that the seller will have discretion with respect to how to treat the customer.

A glib counter-intuitive analysis may be correct, but one might think the need to retreat would commend some circumspection. Does one truly envision businesses cowered into providing unduly favorable contract terms by unreasonable consumers?

Consider the following term in a credit card contract:

You may reject the Arbitration of Disputes section but only if we receive from you a written notice of rejection within 30 days of your receipt of the Card. You must send the notice of rejection to: Discover, PO Box 30938, Salt Lake City, UT 84130-0938. Your rejection notice must include your name, address, phone number, Account number and personal signature. No one else may sign the rejection notice for you. Your rejection notice also must not be sent with any other correspondence. However, if you previously had the chance to reject an arbitration agreement with us but did not, you may not reject it now. Rejection of arbitration will not affect your other rights or responsibilities under this Agreement or your obligation to arbitrate disputes under any other account as to which you and we have agreed to arbitrate disputes. If you once sent us a rejection notice on a different account or card, you must send us a new rejection notice or else this arbitration agreement will apply to any disputes with us relating to your other accounts or cards.\textsuperscript{5}

Note the anomalous asymmetry: A rejection of arbitration under another account does not operate to reject arbitration as to this account. However, any prior failure to opt-out under a prior account prevents opting-out as to this account. And, failure to reject arbitration under this agreement will retroactively impose arbitration under preexisting relationships.

Why would a large business propose such a complicated and odd arrangement? A third-party observer cannot say for sure. But the arrangement seems at least plausibly designed to take advantage of frictions in contract formation in order to increase the likelihood that some consumers will be bound by arbitration. That is, it seems entirely possible that, if frictions can allow the persistence of suboptimal contract terms, sophisticated parties may craft their styles of contracting to take advantage of those frictions to their benefit—to increase the frequency with which they benefit from suboptimal contract terms that are favorable to them.

The focus of this article is modeling and estimation of the circumstances in which ancillary contract terms that are not joint-wealth-maximizing can persist in a competitive market. One assumption in modeling would require limited rationality. Korobkin goes so far as to state, “The behavioral

economic analysis of law has become the economic analysis of law.\textsuperscript{6} Modeling behavior assuming assorted cognitive biases is problematic, given, as Wright and Ginsburg\textsuperscript{7} note, the unpredictability of combinations of cognitive biases. In addition, it is preferable to adopt less intrusive assumptions—i.e., it is preferable to avoid strong assumptions—if weaker assumptions illuminate relationships of interest.

This article shows more parsimonious assumptions—assumptions less objectionable than irrationality—can produce steady-state market share for those offering contract terms that are not joint-wealth-maximizing. In lieu of reliance on behavioral assumptions, this article builds on the development of frictions and search theory. Modernly, search theory is prominently examined in the context of the theory of unemployment by Diamond, Mortensen, and Pissarides,\textsuperscript{8} to which some passing reference has been made in the law review literature.\textsuperscript{9}

Our objectives in this article are:

\begin{itemize}
  \item To illustrate that plausible levels of frictions in market transactions can, in some circumstances, result in perpetuation of inferior (suboptimal) contract terms—that the frictions can be sufficient to overcome market forces that might otherwise be predicted to eliminate the inferior terms;
  \item To identify some circumstances that may make it more likely frictions will allow perpetuation of suboptimal terms; and
  \item To sketch outlines of legal principles that can be used to mitigate the efficacy of opportunistic structuring of methods of securing mutual assent designed to capitalize on frictions to secure preferential, but collectively suboptimal, contract terms.
\end{itemize}

**I. SEARCH COSTS AND ANCILLARY CONTRACT TERMS**

The significance of search costs in pricing of contractual relationships extends back at least to Stigler's 1961 article, where he notes, "Only those

\begin{itemize}
\end{itemize}
differences could persist which did not remunerate additional search.... But, indivisibilities aside, it would normally be unprofitable for buyers or sellers to eliminate all dispersion.”

Stigler, in examining search for alternatives, further notes, “The maintenance of appreciable dispersion of prices arises chiefly out of the fact that knowledge becomes obsolete.”

This insight reveals why a dynamic model is necessary to examine the relationships. It is the delay in full dissemination of information to market participants and potential market participants, and their delay in processing information, that may allow inferior market terms to persist. A dynamic relationship dependent on factors that vary materially over time cannot be adequately analyzed by a static model.

Stigler’s work examines market variation as to price; his examination references “[t]he search for knowledge on the quality of goods” as something which “has been studiously avoided” in his article. One might classify a contract’s terms as an aspect of “quality” that is not separately priced—the type of matter Stigler’s work elides.

Ancillary terms of consumer contracts are qualitatively different in terms of the extent to which undesirable terms can persist. Basic bargaining typically does not focus on these terms. Hence, disparities among these terms, and undesirable terms, can persist longer, by virtue of the increased frictions associated with altering the terms.

Numerous works reference what might be classified as frictions in limiting the development of jointly-desirable contract terms. Posner himself recognized them in the 1986 version of his seminal work Economic Analysis of Law:

An objectionable feature of some printed contracts is the use of fine print or obscure terminology to slip an onerous provision past an unwary customer; and such conduct is more likely in a monopolized than in a competitive market.

A thoughtful analysis was provided in 1990 by Meyerson, who notes:

11 Id. at 220.
12 Id. at 224.
13 POSNER, supra note 2, at 103.
Subordinate terms will not be known because the cost of acquiring the necessary information exceeds the expected gain to the consumer from that information . . . .

The cost to the consumer is made all the more excessive by the high cost of understanding a term’s legal significance. Again, some sellers try to increase this cost by hiding the term’s meaning in obscure “legalese.”

This view seems now well-settled. For example, Shavell notes the relevance of search costs in formulation of contract terms: “An important aspect of contract formation is the effort individuals devote to it—the time and resources they expend searching for and investigating contractual opportunities.”

Posner’s discussion continues, purporting to cabin restrictions on this opportunistic behavior within “species of fraud”:

But to thus impose excessive search costs on buyers is, analytically, a species of fraud (though one rarely actionable) rather than an exercise in bargaining power.

As illustrated in Part V, infra, there are actually many cases that, in a variety of contexts, deny enforceability to this opportunistic behavior, many referencing standards that are a far cry from the onerous elements of fraud.

Modern economic work on search costs has identified circumstances where search costs can result in steady-state persistence of undesirable terms. Gabaix and Laibson’s 2006 work, which examines what they describe as “shrouded attributes,” provides an illustration. The basic concept involves service providers who over-charge “myopic” customers for ancillary services, the cost of which can be avoided by informed customers (by acquiring

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16 POSNER, supra note 2, at 103.
18 Id. at 512.
To illustrate, they contemplate excessive costs for hotel parking, for which alternative transportation could substitute. Over-charging myopic customers allows for subsidization of informed customers. A competitor cannot acquire business by properly pricing each component and advertising, because that will simply drive the informed customers to the firm that subsidizes informed customers by over-charging myopic customers. Gabaix and Laibson provide more detail for the illustration, which is reproduced in the margin.19

Certainly some ancillary contract terms may involve an add-on for which a substitute may be available. Perhaps illustrative would be rental car provisions imposing damage liability on the customer, where the customer can arrange some substitute by using a credit card that provides insurance. However, in many cases a substitute cannot be obtained for inferior contract terms. For example, if a provision in a consumer contract requires mandatory non-class arbitration of any dispute, a general way to obtain a substitute for this particular component is not obvious.

The above discussion notes possibilities in which poor terms will persist. Acknowledgement of that conclusion is a first step in informing our understanding of legal doctrine. Yet that observation by itself does not compel a conclusion that some aspects of contract doctrine should be

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19 Id. at 507–08. They write:

To develop intuition for our results, consider a hotel room that costs Hilton $100 to supply. Suppose that all consumers are initially myopic (i.e., they do not think about add-ons when they plan a hotel visit). When such a customer stays at Hilton, she ends up paying $20 to purchase add-ons like parking, telecommunications, room service, etc. Without loss of generality, assume that these add-ons cost Hilton nothing to provide. In a competitive market, Hilton will then advertise “Hilton’s rooms cost only $80,” neglecting to mention the costly add-ons that effectively raise its revenue. In competitive equilibrium, Hilton’s costs ($100) equal Hilton’s total revenues ($80 + $20).

Now consider another hotel chain, called Transparent, that is picking a business strategy. Transparent could tell consumers about the shrouded add-ons that consumers pay for at Hilton. Transparent could advertise, “Watch out for add-on prices at our competitors. Transparent’s add-ons are all free.” Naturally, if Transparent did this, they could not subsidize their room fees with add-on revenue. An aggressive transparency strategy would be to charge $100 for rooms and nothing for add-ons.

Unfortunately, this efficient pricing scheme might not attract any customers. Once consumers understand the high mark-up strategy of Hilton, consumers might prefer to stay at Hilton and simply substitute away from add-on consumption.
adjusted. If contracting generally produces terms inferior by a penny, who cares? A next step would require making some assessment of the magnitude of the impact of these frictions.

Gabaix and Laibson note another factor, market growth, which may play a role in allowing the mispricing they model to persist. Consider the possibility that firms offering latent inferior terms may disproportionately capture new entrants in a growing market. That could occur where new entrants are not well-informed about the pertinent terms, where advertising focuses on more salient features.

This article uses that observation as a basis for benchmarking the potential significance of frictions. Part II of this article frames the following inquiry: How much less disproportionate market capture is necessary to maintain steady-state persistence of inferior terms by virtue of frictions in search? The modeling addresses both frictions inhibiting dissemination of the inferiority of certain terms and switching costs increasing over time, potentially making switching economic.

Difficulty in understanding verbose contract terms needs no further illustration. Switching costs growing over time may be illustrated by choice of computer operating system. Over time, as one increasingly uses the selected system, idiosyncrasies can multiply, increasing switching costs.

Moving beyond mere casual reference to the possible impact of frictions, Part II of this article develops a simple model of frictions relevant to the specification of ancillary contract terms. It provides benchmarks illuminating the extent to which search costs and switching costs may allow steady-state persistence of non-joint-wealth-maximizing ancillary contract terms. After developing the model, this article inspects the parameters necessary to create a steady-state market share that does not vary over time. It would appear the indicated range of parameters is reasonable—that the combination of search costs and switching costs can have a significant impact on producing long-term persistence of inferior terms in a growing market.

Before turning to the modeling, one may note an alternative approach. One could instead assume limited rationality as the reason for the persistence of inferior contract terms. Korobkin goes so far as to state, “The behavioral economic analysis of law … has become the economic analysis of law.” Modeling behavior assuming assorted cognitive biases is problematic, given, as Wright and Ginsburg note, the unpredictability of combinations of

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20 Id. at 522.
21 Korobkin, supra note 6, at 1655.
22 Wright & Ginsburg, supra note 7, at 1065–66.
cognitive biases. This article shows more parsimonious assumptions—assumptions less objectionable than irrationality—can produce steady-state market share for those offering contract terms that are not joint-wealth-maximizing.

II. A SIMPLE MODEL OF MARKET GROWTH AND SEARCH

This article proceeds in steps in building a model that reflects market growth and switching and search costs. In lieu of attempting to model determination of contract terms in a single transaction, the model assumes a multi-period market in which those having inferior terms can switch to vendors offering superior terms, with the market also growing over time, i.e., new customers entering each period.

The modeling treats as fixed merchants' choices whether to offer the inferior terms. A number of circumstances might result in merchants varying as to the selected terms. To illustrate, consider the market for computing devices, where some vendors had initially chosen to use a platform subject to security risks and others had developed more robust platforms. Consider an ancillary term limiting liability for corruption (a security breach) of the device. Those who had chosen a robust platform might provide a warranty at no cost, whereas those who had chosen a poor platform might bury a liability limit in contract terms.

The first step examines solely market growth. It is perhaps obvious that one providing inferior terms can maintain a percentage in a growing market by disproportionately capturing those customers who newly enter the market. Our more complete model illustrates how switching costs and search costs can decrease the necessary excess market capture. But we begin with the model without switching costs, in which all those who become aware of the undesirability of their terms switch.

The first step in our investigation is to assess whether, under some set of plausible assumptions, frictions can result in persistence of suboptimal contract terms. The basic intuition is as follows: In brief, one receiving proposed contract terms—let's identify this person as a consumer, though that is not necessarily the case—will not necessarily fully investigate their contents and import before forming a contract and thus will contract without

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23 One might be tempted to identify that person as the offeree. Of course, it is certainly possible for a merchant to proffer a form by which its customers make offers. International Filter Co. v. Conroe Gin, Ice & Light Co., 277 S.W. 631 (Tex. Comm'n App. 1925), provides an illustration familiar to many law students. Hence the less elegant reference.
knowing the full import of the terms. Subsequent events may reveal the adverse nature of the terms, causing defection to those offering better terms.

Our modeling hypothesizes two processes that can allow undesirable terms to persist. That is not to say these are the only possible factors. Rather, they are the ones that have been selected to be included in the modeling.24

First, the passage of time may result in consumers becoming aware of the inferiority of terms offered by some merchants. But passage of time also may increase switching costs, making a change prohibitive. Consider the ancillary switching costs associated with using alternative word processing software, after having used one version for some time.

Second, where a customer base has new entrants, disproportionate market capture of new customers can assist in allowing inferior contract terms to persist, retaining the same market share, as long as those offering inferior terms disproportionately capture new customers. For ease of modeling, this has been framed in terms of a market that is growing, with current customers not exiting. However, the same kind of results would occur were customers leaving.

Before turning to the details of the modeling, it is helpful to note that the question is being framed in a way that understates the impact of frictions. The ultimately important question—the one relevant to framing the contours of the law of contracts—is not whether frictions create some merchants perpetually contracting using inferior terms. Rather, the question pertinent to informing contract doctrine is whether frictions can cause some relevant amount of suboptimal contracts to be formed and whether the contours of contract doctrine can mitigate the negative impact. Some material fraction of market share perpetually involving inferior terms would be sufficient to warrant consideration of contract doctrine that might mitigate the impact, but it surely is not necessary.

Let us first assume there are two groups of vendors, those with “Good terms” and those with “Bad terms”, perhaps illustrated by a consumer contract requiring mandatory, non-class arbitration of all disputes. There is some defection from the Bad to the Good in each period, as persons

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24 The literature addressing frictions associated with search is voluminous. One relatively recent survey of some of the literature is Richard Rogerson et al., Search-Theoretic Models of the Labor Market: A Survey, 43 J. ECON. L. 959 (2005). So, it is not suggested the basics of the approach to the modeling in this article are unique, or that they are the most refined. Rather, this paper is using basics from the development of analyzing markets with frictions to investigate a particular context: ancillary contract terms. See Randall Wright, Markets with Frictions (Jun. 27, 2014), https://class.coursera.org/marketswithfrictions-001, for an introduction to these principles.
contracting with the providers having poor terms learn of the problem (in our illustration, some set of breaches are without a practicable remedy), and defect to the provider with better terms. There are also new entrants.

The modeling treats as fixed merchants' choices whether to offer the inferior terms. This may be depicted in the below chart:

The existing market has some set of merchants offering Good terms and some set offering Bad terms. The market grows in a period by a fraction $\eta$ of its existing size. To illustrate: Assume a market at the beginning of 100 clients, with 30 having Bad terms and 70 having Good terms. The market grows by 10% (or 10) in the period. In this case $\eta = 0.10$. Some of the new market entrants (10 in our example) would be captured by those offering Bad terms, with the remainder captured by merchants offering Good terms. Some number of those in the market at the beginning and having Bad terms (some fraction of the 30 in our example) become aware of the inferiority of the terms they have and defect to merchants offering Good terms. That is represented by $a$, for attrition, in the above diagram. It represents the fraction
of those having Bad terms at the beginning of the period who become aware of the inferiority of their terms and can switch. We will be investigating what is necessary to keep a steady-state.

**No Attrition.** Obviously, if the attrition \( a \) equals zero, then steady-state simply requires that each merchant offering Bad terms must capture a fraction of the new entrants equal to its fraction of the market at the beginning of the period. So, continuing our example, a market size of 100, 30 being customers having Bad terms, with 10 new entrants in the period, those offering Bad need acquire \( \frac{30}{100}, 30\% \), of the new market entrants, or 3.

It will be easiest to define a term that we can call the *inflow rate.*

That is defined as:

\[
\frac{\text{number of new customers merchants offering Bad terms must capture}}{\text{number of existing customers having Bad terms}} = \text{inflow rate} \times \frac{\text{number of existing customers having Bad terms}}{\text{number of existing customers offering Bad terms}}
\]

Where there is not any attrition of existing customers from merchants offering Bad terms to those offering Good terms, the *inflow rate* equals the rate of growth of the market \( \eta \):

\[
inflow rate = \eta
\]

**Attrition and No Switching Costs.** Let us now define precisely \( a \), the attrition rate, as being the fraction of those who have Bad terms and who can switch that do, in fact, switch to a merchant having Good terms in the period. At the moment, we assume there are not any switching costs. So, in this case, all who become aware of the inferiority of their terms do switch. That will increase the *inflow rate* necessary to keep a steady-state market percentage. One can identify that by inspection:

\[
inflow rate = \eta + a
\]

Continuing our numerical example, now assuming an attrition rate \( a \) equal to 2%, our above example, the *inflow rate* necessary to keep a steady-state market percentage would equal 12%, or 3.6 where the period-beginning number of customers having Bad terms is 30.

We can see that is obviously correct. With an attrition rate of 2%, 0.6 customers defect to merchants with Good terms. So, to cause the number of customers with Bad terms to be 33 (increasing by 10% during the period), merchants with Bad terms must first capture 0.6 who defected and then an
additional 10% of the 30 customers at the beginning of the period. The sum, 3.6, is 3.6/30, or 12%.

For reasons that will become clear below, it becomes easier to compare this inflow rate if we state it as:

\[ \text{inflow rate} = \eta \left(1 + \frac{\eta}{\gamma}\right) \quad (I) \]

Attrition and Switching Costs. The relationship becomes more complicated when one also incorporates some fraction of those having Bad terms becoming unable to switch. For convenience, a flow chart illustrating the steps is in Appendix I.

The results cannot be derived by inspection. We will leave the derivation to Appendix II, and at this point simply identify the answer.

To identify the answer, we need first to formulate the restrictions on switching. Here we will assume that in each period, some fraction of those who can switch become unable to switch. Let us use the variable \( \psi \) to identify that fraction (percentage). For example, if \( \psi = 0.05 \) (5%), in a market containing 30 having Bad terms who, at the beginning of the period, could switch, and an attrition rate \( a \) of 0.02, the number switching in that period would be found by:

\[
\text{The number who could switch in the period} = 30 \times (1 - 0.05), \text{ or } 28.5. \text{ Thus, the number who do switch in the period} = 28.5 \times 0.02, \text{ or } 0.57.
\]

An inflow rate in this case is more complicated to derive, because it depends on the number of those with Bad terms for whom switching has become not economic. Let us continue with a market having 100 customers, 30 of whom have Bad terms, with the market growing at 10%. If all with Bad terms can switch, the needed inflow rate is: 3.57/30, or 11.90%.

And, as noted above, as of the end of that period, there are 1.5 customers who cannot switch. The remaining 31.5 customers can switch. That is the composition of the customers having Bad terms as of the beginning of the next period.

Continuing, the additional number that becomes unable to switch in this second period is: 31.5 \times 0.05, or 1.575. Therefore, of the 33 customers with Bad terms, those who cannot switch number: 1.5 + 1.575, or 3.075 customers. Thus, the number who do switch in the period is: \((33 - 3.075) \times 0.02, \text{ or } 0.5985.\)
The number of new customers needed to maintain a 30% market share (increasing the period-beginning market size of 33 by 10%, the growth of the market each period) equals $3.3 + 0.3985$, or 3.8985. That equates to an inflow rate of $3.8985/33$, or 11.81%.

That is, the inflow rate decreases in the second period, because the number of customers having Bad terms, who begin the period being unable to switch, increases. With a little algebra, shown in Appendix II, one can determine that when a steady-state is reached, there is the following inflow rate:

\[
\text{inflow rate} = \eta \left(1 + \frac{\alpha}{\eta} \frac{\eta(1-\psi)}{\eta+\psi}\right)
\]  

(II)

Thus, switching costs decrease the required excess new entrant capture by the multiple of:

\[
\frac{\eta - \eta \psi}{\eta + \psi}
\]

It may be more convenient to depict that factor when restated as:

\[
\frac{1 - \psi}{1 + \frac{\psi}{\eta}}
\]
We can illustrate the impact switching costs have on the excess new entrant capture required in the following figure:

**Figure 1. Extent to which Switching Costs Decrease Required Excess New Entrant Capture**

Fraction by which excess inflow needed to offset attrition is decreased by switching costs. \( \eta = 0.05, 0.10, 0.20, \) and \( 0.30 \), in the following diagram (moving to the North-East for increasing \( \eta \), so that \( \eta = 0.30 \) is the upper-most plot).
For example, assume those offering Bad terms comprise 30 in a market of 100 that grows and that merchants with Bad terms are required to receive 36% of the new clients entering the market in the absence of switching costs.

Illustrative would be market growing at 10% per period, with a 2% attrition per period from merchants offering Bad terms to those offering Good terms. So, in the period, 0.6 of the 30 would defect. To maintain a 30% share in a market growing 10% per period, those offering Bad terms would need to capture \( 3 + 0.6 \) new entrants. \( (3 + 0.6) / 30 = 12\% \).

This corresponds to the results from Equation 1, for these parameters:

\[
\text{inflow rate} = 10\% \left( 1 + \frac{0.02}{0.10} \right) = 12\%
\]

For this illustration, a value in the above diagram of 0.63 would correspond to switching costs reducing from 36% to 33.8% the amount of new clients entering the market required to be captured by those offering Bad terms to maintain steady state. That is computed, from Equation II, as: \( \text{inflow rate} = 10\% \times (1 + (0.02/0.10) \times 0.63) \), or 11.26%. Thus, maintaining steady state would require capture of \( 30 \times 0.1126 \), or 3.38 of the 10 new market entrants (33.8%). (In a steady-state, there is, of course, at the beginning of each period some number of customers who cannot switch.)

The illustrative computation assumes a two percent attrition per period. This figure was intended merely as something useful for an illustration. Recent evidence puts in context a selection of an attrition rate. Bakos et al. recently report that, in a large sample of web site visitors (48,154), approximately one in five hundred access a product’s end user license agreement for at least one second, which they suggest is too small to give rise to an informed-minority equilibrium.

III. DELAYED INVESTIGATION OF TERMS

Our discussion in Part II illustrates that switching costs can impede the extent to which market forces act to eliminate collectively suboptimal contract terms in ongoing (multi-period) contractual relationships. A question arises as to why a party entering into such a relationship on terms proffered

25 Yannis Bakos et al., Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts, 43 J. LEGAL STUD. 1, 3 (2014).
26 Id. at 27. The modeling in Part II introduces dynamic elements not presented in Bakos et al.’s brief discussion of the equilibrium.
by the other does not, up front, investigate the terms. One might consider the following relationship:

\[ \text{period 0 investigation cost} < \frac{\text{higher return}_1}{(1 + i)} + \frac{\text{higher return}_2}{(1 + i)^2} + \ldots \]

Here we are assuming a contractual relationship giving periodic benefits each period, with a discount rate of \( i \) per period, and an investigation cost at the beginning (period 0). If the higher return from investigation is the same in each period, either an investigation is made initially or it is never made. The choice is made initially. That's because if an investigation is not made at period 0, the decision is the same at period 1. The decision-maker does not receive the higher return in period 1 but, in period 1, faces the same choice. The references to the periods are all decreased by 1, and everything is the same. That's the case for high or low interest rates—either it is profitable to investigate in the first period or it is never profitable.

That does not really comport with one's intuition. Folks often postpone decisions. A reason why that might be the case arises from some equivalence between a discount rate and a probability of a repeated event. Algebraically, the value of a probability of 90% of receiving $1 in one year from now, where there is no discount rate, is the same as a 100% probability of receiving $1 one year from now where there is a 10% discount rate. Each is worth (has an expected present value) of $0.90 today.

The algebraic insight alone is not innovative. However, understanding that, we can see how an investigation may profitably be postponed. At period 0, the higher return for periods 2 and following are essentially discounted by both the discount factor (time value of money) plus the probability that the relationship will not continue.

For example, let's say I am signing-up for some online community that, for a fee, will connect me with, and allow me to communicate with, and sell to, potential contracting partners. It's a monthly arrangement. If this is a low-cost proposition, for the first month, if I expect there is a low probability I will continue to use the service, I may not pay much attention to the ancillary terms. However, the next month, the probability that I will continue to use the service in future months may change. If it increases, the value of my investigating the contract terms, e.g., to see if there is a way I can opt-out of mandatory arbitration that I perceive will benefit me in future periods, may now increase to where it becomes profitable to investigate the terms. It is also possible that delay will increase the likelihood of, or decrease the cost of, successful investigation. One can become aware of the adverse consequences
of particular contract terms through a network of acquaintances. As the network of users grows, it is more likely another network member will be informed. Thus, we can envision circumstances where onerous contract terms are particularly likely to arise in multi-period relationships where the likelihood of renewal is low.

IV. CIRCUMSTANCES EXACERBATING IMPACT OF FRICTIONS

Our above discussion illustrates there are circumstances in which frictions can materially influence the contours of agreements and result in the persistence of inferior contract terms. Intuition on its own may well have led one to that conclusion. We have above simply provided a more rigorous development of the principle.

There are many aspects of contract doctrinal development that might benefit by reference to frictions in contract formation. They are too numerous for all to be addressed. Instead, we first turn to identifying some attributes the basic modeling indicates may result in frictions being of particular significance. This discussion identifies circumstances where the deleterious impact of frictions is most prominent. We then examine possible development or refinement of selected contract principles in light of the insights. The objective is to illustrate the kind of authority on which a court could draw in adjusting legal doctrine to accommodate the concerns identified by referencing frictions and, at the same time, maintain fidelity with extant jurisprudence. In particular, we can identify a variety of authority that can be revitalized in the process of adjusting illustrative principles of contract doctrine to accommodate our understanding of the impact of frictions.

We may quickly identify a number of circumstances where the presence of frictions may be particularly likely to facilitate opportunistic behavior in the formation of contracts.

Small Contract Value. Frictions more often will be important for contracts with a relatively small value. The impact of frictions will increase as the magnitude of the friction increases relative to the value of the contract—perhaps proportionally, perhaps not. Components of the frictions do not depend on the size of the value of the contract. For particular contractual language, the cost to understand it typically would not depend on the dollar value of the subject matter. Thus, the small magnitude of an individual transaction particularly presents opportunities for opportunism relying on frictions. And, of course, the aggregate value realized by opportunistic
behavior involving small transactions need not be small, if it arises from large numbers of small transactions.

**Sequencing of Relationship-Specific Investments.** Circumstances involving the sequencing of relationship-specific investments may enhance the ability to use frictions opportunistically.\(^{27}\) Formation of mutual assent can result in relationship-specific investments before mutual assent is formed. That might include, for example, the cost of traveling to a vendor to purchase a good or service. The vendor first visited can offer arrangements that are worse than those offered by competitors, as long as the difference is less than the cost of travel to a different vendor.

That might also include the delivery of unordered goods or services. Putting aside for the moment the special legal treatment of mutual assent concerning receipt of unordered goods or services,\(^{28}\) the convenience cost associated with returning the good or avoiding using the service are like transaction-specific investments, making other arrangements relatively more expensive.

Of course, in many cases, it would not be in a vendor’s interest to send an unsolicited good. The cost if assent to a contract is not formed may be prohibitive. Those problems for the opportunist, however, may be substantially decreased in the case of certain services, such as computer-related services, where the marginal cost of providing the service is negligible.

**Multi-period Contracting.** That the relationship involves multi-period contracting can increase the practicability of opportunistic behavior using frictions. The possibility the relationship will not be renewed in a subsequent period may decrease investigation of ancillary contract terms. Particularly in combination with the possibility of switching costs increasing from period to period, this circumstance may allow opportunistic behavior to result in persistence of collectively inferior contract terms.

**New Customers; Growing Market.** New customers entering a market may influence the persistence of inferior contract terms. If one becomes aware of the inferiority of contract terms because one is a market participant, i.e., only casually, as a customer, new customers entering the marketplace can allow persistence of inferior contract terms. This can occur where the market size remains the same, as the infusion of new, uniformed customers dilutes the


\(^{28}\) See infra notes 67-68 and accompanying text.
extent to which customers overall are knowledgeable. That a market is growing rapidly may decrease the percentage excess market capture necessary for those offering inferior terms to maintain a steady-state market share.

**Bifurcation of Contract Terms.** An opportunist’s ability to discriminate among customers as to contract terms may facilitate persistence of inferior contract terms. One factor that may restrain opportunism is loss of business of those who are informed as to inferiority of possible contract terms. If an opportunist contracts on the same terms to all, it will discontinue offering inferior terms where profits lost from defection of knowledgeable customers exceeds the benefits opportunistically extracted from the uninformed. The opportunist’s solution to this problem may include bifurcation of contract terms, so that uninformed have inferior terms whereas profits are still realized from the informed who opt-out of the inferior terms.

**V. OVERLOOKED AND SUPPORTING DOCTRINAL DEVELOPMENTS**

A number of statutory provisions governing contract formation and performance may be harmonized with our understanding that a class of parties might otherwise seek to use frictions to obtain collectively suboptimal contract terms. For example, some statutory provision may require cash redemption of gift cards having a small value. There is not an apparent reason why the prohibited conduct would be in the aggregate best interest of the parties. The statute merely prohibits a reallocation of value so small that it might not give rise to attempts to address the problem.

Another example: The U.C.C. allows a party to designate a separate address for communications purporting to offer to settle a dispute (so that cashing an accompanying check would operate to accept the settlement). This provision addresses the following basic problem: A party currently owing another money, perhaps a disputed debt, seeks to obtain unknowing assent to a contract. To do so, it proposes contractual terms when sending a check, proposing that cashing the check operates as an assent. The concern is the recipient’s cashing of the check will create inadvertent assent.

This circumstance illustrates an attempt to use frictions to obtain terms superior to those that could be obtained through express bargaining. There is

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30 U.C.C. § 3-311(c)(1) (2004).
a cost associated with having each person who receives checks, purportedly in payment, confirm the existence of possible contract proposals that will be accepted on cashing checks. This statutory provision decreases the ability of a party to use frictions to obtain superior contract terms, by making effective arrangements that only communication addressed in a particular way needs be reviewed for contract terms.

This provision more typically benefits merchants in merchant/consumer contracts, because it would be the merchants who typically would receive payments. The U.C.C. also has terms that might, in consumer contracting, more typically benefit consumers, mitigating the consequences of others’ attempts to use frictions to obtain suboptimal contract terms. U.C.C. section 2-316(2)\(^{31}\) limits the effectiveness of certain disclaimers of warranties that are not conspicuous. This provision restrains some attempts to use the friction costs associated with reviewing contract terms to purport to offer goods with warranty terms superior to those actually offered.

Consumer protection provisions can similarly restrain this opportunistic use of frictions. For example, bait advertising\(^{32}\) can create suboptimal relationships where the inferiority (or expected inferiority, viewed as of the time the consumer is present at the bait advertiser’s establishment) of the bait advertiser’s arrangements equals the convenience cost of going elsewhere.

Another example is provided by assorted provisions allowing persons receiving unordered merchandise to keep it without paying.\(^{33}\) This kind of arrangement is less likely to be undertaken opportunistically in the context of parties having an ongoing relationship for the resale of the goods. Opportunism may poison an ongoing relationship. Authority indicates the federal prohibition does not apply to transactions between parties with an ongoing resale relationship.\(^{34}\) So, the contours of this federal prohibition conform to the concerns of opportunism: The federal prohibition does not apply in contexts where the acts are less likely to be part of an opportunistic scheme.

A third example is provided by prohibitions on, and the regulation of, the use of offers formulated as simulated checks.\(^{35}\)

\(^{31}\) U.C.C. § 2-316(2) (2012).

\(^{32}\) See 16 C.F.R. § 238.3 (Westlaw through June 19, 2014) for Federal prohibitions on bait advertising.

\(^{33}\) See infra notes 67–72 and accompanying text.

\(^{34}\) See infra notes 68–69 and accompanying text.

\(^{35}\) CAL. BUS. & PROF. CODE § 17539.1(a) (Westlaw through urgency legislation through Ch. 25, also including Chs. 39 and 41 of 2014 Reg. Sess., Res. Ch. 1 of 2013-2014 2nd Ex. Sess., and all propositions on the June 3, 2014 ballot) (restricting the use of simulated checks).
Only particular circumstances are addressed by these statutory provisions that restrain a party’s taking advantage of frictions in contract formation, for purposes of securing beneficial, but collectively suboptimal, contract terms. The question arises whether extant common law doctrine constrains courts addressing circumstances outside the scope of statutory provisions, impeding doctrinal development that can restrain a party’s securing beneficial terms that are collectively suboptimal.

An unrefined view of contract doctrine would suggest courts have limited tools to address these circumstances, other than infrequently-used principles of unconscionability. The primitive view is there is a duty to read an offer, so that failure to inform oneself of the pertinent offered contract terms immunizes them from challenge,\(^3\) in the absence of extraordinarily unfavorable terms that trench on public policy concerns, are proffered by fiduciaries, are unconscionable or the like. This conceptualization seems a consistent part of the general objective approach to formation of mutual assent.

checks in advertising); id. § 22433 (prohibiting certain uses of simulated checks); CONN. GEN. STAT. § 36a-497(2) (Westlaw through enactments approved by the Governor on or before June 6, 2014 and effective on or before July 1, 2014) (prohibiting certain uses of simulated checks by mortgage lenders or brokers); id. § 42-299 (prohibiting use of simulated checks in connection with sweepstakes unless the simulated check is clearly annotated); LA. REV. STAT. ANN. § 51:1723(C)(1) (West, Westlaw through the 2013 Regular Session) (requiring conspicuous disclosure on simulated checks used in the solicitation of sale or lease of goods or services); N.H. REV. STAT. ANN. § 358-O:6 (West, Westlaw through Chapter 81 of the 2014 Reg. Sess., not including changes and corrections made by the State of New Hampshire, Office of Legislative Services) (requiring the same in a consumer transaction); N.Y. GEN. BUS. LAW § 396-aa.2 (McKinney, Westlaw through L.2014, chapters 1 to 30, 50 to 60) (prohibiting distribution of simulated check not conspicuously containing a specified disclaimer); N.C. GEN. STAT. § 75-35 (West, Westlaw through S.L. 2014-2 of the 2014 Regular Session) (prohibiting issuance of writings that simulate negotiable instruments); R.I. GEN. LAWS ANN. § 42-61.1-5(1) (West, Westlaw through Chapter 334 of the January 2013 session) (requiring conspicuous disclaimer in use of simulated check in a consumer transaction); S.C. CODE ANN. § 37-15-60(1) (Westlaw through end of 2013 Reg. Sess.) (same); VA. CODE ANN. § 59.1-419 (West, Westlaw through End of the 2013 Reg. Sess. and the End of 2013 Sp. S. I and includes 2014 Reg. Sess. cc. 1, 2, 8, 23, 29, 47 and 59) (requiring conspicuous disclaimer in use of simulated check in a consumer transaction); WASH. REV. CODE ANN. § 19.170.050 (West, Westlaw through 2014 Legislation effective on June 12, 2014, the General Effective Date for the 2014 Regular Session, and 2014 Legislation effective July 1, 2014) (requiring specified disclosure on simulated check); W. VA. CODE ANN. § 46A-6D-6 (West, Westlaw through laws of the 2014 Regular and First Ex. Sess. with effective dates through June 2, 2014) (requiring conspicuous disclaimer in use of simulated check in a consumer transaction).

\(^3\) See infra note 43.
There are, of course, some obvious detours from this objective approach. As is familiar to students of contract doctrine, one anomalous deviation from that objective approach is the treatment of ambiguity, where one party is aware of the ambiguity and the other is not. The traditional doctrinal answer, reflected in the Restatement, is a party cannot take advantage of the other’s ignorance of ambiguity, requiring an ambiguous provision be construed against the sole party aware of the ambiguity.\(^\text{37}\) Subjectivity is also referenced in the doctrine governing mistake, where a party’s awareness of the other’s mistake can be a factor relevant to the availability of the defense.\(^\text{38}\) Were the common law not this way, the circumstance could facilitate a better-informed party’s reliance on frictions—costs that would be incurred by the other in informing itself—to secure terms beneficial to it but collectively suboptimal.

To the uninitiated, those approaches, however, seem like outliers in the common law, with the harsh approach reflected in a duty to read reigning elsewhere. A more careful examination of precedent, however, reveals a remarkable lack of uniformity in this regard. As the common law was developing, quite a bit of authority short of the bludgeon of unconscionability restrains techniques relying on frictions to secure beneficial contract terms. To illustrate the approach a court might take in seeking to incorporate the understanding of frictions in developing contract doctrine, this article focuses on the following issues:

- The extent to which extrinsic language can be effectively incorporated by reference into a contract;
- The extent to which silence operates as an assent; and
- The extent to which tickets, and other language not exclusively designed to communicate contract terms, can set contract terms.

Each presents assorted opportunities for one party (or one class of parties) to frame the mutual assent process so that frictions may facilitate persistence of collectively inferior contract terms that benefit that party.

\(^{37}\) See Restatement (Second) of Contracts § 20(2) (1981).
A. Incorporation by Reference

It is possible for an offer to incorporate by reference extrinsic language. It could be language from something designed to be part of a contract. But it need not be. An offer can incorporate by reference statutory language,\textsuperscript{39} language from an administrative rule\textsuperscript{40} or something else.\textsuperscript{41} The effect of incorporation by reference is to treat the extrinsic language as if it were reproduced in the incorporating document.\textsuperscript{42}

The relevance of incorporation by reference to our purposes of investigating frictions in contract formation is that this style of contracting can increase an offeree's cost of apprising itself of the import of proposed terms. That can happen in a few ways. There may be inconvenience cost in obtaining the document. In addition, the ability to incorporate extrinsic writings facilitates the provision of more detailed contractual terms—they need not be printed in something that has to be delivered to the other party. More detailed contractual terms may be more expensive to review. So, the ability to incorporate by reference an extrinsic writing may increase the costs of an offeree's review of the pertinent terms.

To illustrate, a party offering inferior services might seek to realize pricing comparable to that realized by those offering superior services by decreasing remedial rights available to its customers through obscure latent contract provisions incorporated by reference. Obscurity of the terms may increase frictions and increase market share relative to that which would be realized were customers fully informed.

A facile analysis of the legal issues presented by this opportunistic use of incorporation by reference might be:

An offer may properly incorporate by reference adequately identified extrinsic terms. An offeree who purports to accept has a duty to read proposed contract terms. The accepting offeree therefore will be bound by those terms the offer purports to incorporate.\textsuperscript{43}

\textsuperscript{39} Longfellow v. Sayler, 737 N.W.2d 148, 154 (Iowa 2007).
\textsuperscript{40} Id.
\textsuperscript{41} E.g., Interwest Constr. v. Palmer, 923 P.2d 1350, 1358–60 (Utah 1996) (addressing incorporation of industry standards promulgated by the National Bureau of Standards).
\textsuperscript{43} E.g., Dow Corning Corp. v. Weather Shield Mfg., Inc., 790 F. Supp. 2d 604, 611 (E.D. Mich. 2011) ("A party cannot later plead ignorance as an excuse if the contract is clear on its face that such terms were intended to be incorporated and failure to obtain an
However, a court thoughtfully considering the circumstances has a variety of techniques at its disposal that, consistent with certain prior authority, can reach a different result.

Some old authority directly identifies this possibility and rejects application of ordinary principles that would effectively incorporate extrinsic language by reference where the technique would inject terms that are not usual or reasonable, “imperfectly described . . . [that] did not give fair notice,” or where the technique is used in an “apparent attempt to explain a contract demonstrates negligence.”); Gray & Co. Realtors, Inc. v. Atlantic Housing Found., Inc., 228 S.W.3d 431, 436 (Tex. App. 2007) (stating, after referencing an obligation to read documents one signs, that “This obligation would logically and necessarily include knowing the terms of any separate sales contract explicitly referenced in a representation agreement.”).

Even as to this bromide, some authority indicates that this kind of determination is for a jury. A Missouri opinion says the following as to a claim that an initial offeror had accepted a counter-offer made by penning-in a proviso on a form of contract and returning it to the original offeror:

In order to bind the defendant in this new proposal, it devolved on the plaintiff to introduce some evidence tending to prove that the defendant assented to the new proposition. The court in its instructions assumed that there was such evidence, and this is the real question. The rule is that there is no contract until both parties assent to the same thing in the same sense. A proposition becomes a contract only when the party receiving it communicates, either actually or constructively, his acceptance to the other contracting party. Express notice of acceptance is dispensed with, when apparently not contemplated; but in such a case the acceptance must be clearly manifested by some other act. The burden of showing this is on the party seeking to obtain the benefits of the contract. In the case before us we think that there was sufficient evidence of acceptance by the defendant to carry the question to the jury. The defendant admitted that he received the instrument sent to him through the mails. From this admission the jury would be authorized to draw the inference that he read it. Whether the defendant’s evidence to the contrary was sufficient to rebut such an inference was for the jury. This rule of evidence is frequently applied in actions on accounts stated, where it appears that a party has received a statement of his account through the mail, and has made no objection to it. If the defendant did not assent to the contract as modified, which necessarily implies knowledge of the change, there was no necessity of direct or actual notice of acceptance, because nothing else was required to be done by the plaintiff to make the contract complete. The defendant’s subsequent conduct in treating the plaintiff as a subcontractor was evidence of acceptance on his part. We must, therefore, conclude that the court committed no error in submitting this issue to the jury.


overreach or deceive.” Other authority implicitly rejects incorporation by reference involving “unfair dealing.” Although courts typically reject a

45 Annotation, Effect of Party’s Ignorance of Contents of Extraneous Paper upon Attempt to Incorporate It into Contract by Reference, 70 L.R.A. 106, 108–09 (1906) (“As above intimated in several decisions, the rule shown, while apparently unbending in the absence of fraud or any element of that nature, becomes nullified by any apparent attempt to overreach or deceive by means of embodying the conditions of the contract in an extraneous document.”).

Friedman v. Hundeinman, 90 N.E.2d 31 (N.Y. 1949), illustrates reasonableness limits on the incorporation by reference of extrinsic language, if giving effect to the incorporation would unreasonably alter the express terms of the incorporating document. A buyer of real estate assigned rights under the contract to a third party. The assigned contract stated the buyer was to take title “[s]ubject to covenants, restrictions and easements of record.” Id. at 33–34. The assignment stated the assigned contract was “made a part” of, i.e., incorporated by reference into, the contract of assignment. Id. at 33. The contract of assignment expressly conditioned the assignee’s obligation to perform on receipt of insurance of good and marketable title. Id. at 32. The required insurance could not be obtained by virtue of restrictions of record. The court held that the incorporated provision did not prevent the assignee’s exercise of the condition in the incorporating document: “We may not by construction excise from the February agreement paragraph 2c, which the parties intended should define their rights and obligations; nor may we insert in that paragraph following the phrase ‘good and marketable title’ the words ‘Subject to the covenants, easements and restrictions of record.’ In other words we may not ‘make a new contract for the parties under the guise of interpreting the writing.”’ Id. at 34 (quoting Heller v. Pope, 164 N.E. 881, 882 (N.Y. 1928)).

46 E.g., Batter Bldg. Materials Co. v. Kirschner, 110 A.2d 464, 468 (Conn. 1954) (“Nor is a party allowed, in the absence of accident, fraud, mistake or unfair dealing, to escape his contractual obligations by saying, as each of the plaintiffs does here, that he did not read what was expressly incorporated as specific provisions of the contract into which he entered.”).

Williston provides an extensive extract from an English case, Phoenix Insurance Co. of Hartford v. De Moura, [1929] 141 L.T. 439, 442 (H.L.), affirming a determination that a provision in a policy specifying the time by which an action must be brought, not referenced in the certificate, is not incorporated into the certificate and, therefore, not binding. 4 SAMUEL WILLISTON & WALTER H.E. JAEGGER, A TREATISE ON THE LAW OF CONTRACTS § 628, at 911–13 (3d ed. 1961). The opinions in Phoenix reference the infeasibility of obtaining access to the pertinent provision and the one-sided nature of the purportedly incorporated terms as bases for not giving effect to the purported incorporation. Phoenix, [1929] 141 L.T. at 439 (“It follows, I think, that all clauses of the policy which are essential to the contract of marine insurance must be read into the certificate, but beyond that there is no necessity to go. The condition in question is a collateral stipulation imposing a condition precedent. It has nothing to do with insurance particularly, but might be applied to any contract. Common sense and fairness revolt against the idea of this being enforced against the holder or indorsee of the certificate. Neither the holder, as here, nor a possible indorsee could ever have seen the policy. There is not even expressed in the certificate a right to ask for exhibition of the policy. Against them it may be fair to assume ordinary insurance clauses, but not to assume a collateral agreement of this sort.”) (Viscount Dunedin); id. (“... a buyer were told [of the terms], I am sure that he would have none of it, and under these circumstances I think the courts
requirement of rote recitation of particular words to effect incorporation—what is required is a manifestation of an intent to be bound by the extrinsic writing)—the requirement that incorporation be effectively communicated can provide some leeway to—a “covert tool,” in Llewellyn’s language for—a court inclined not to incorporate extrinsic language by reference. And one case references the ease with which allegedly incorporated language could have been included in concluding extrinsic language is not effectively incorporated.

There are other context-specific principles that can restrain this opportunistic approach to setting of contract terms: Some authority finds ineffective attempted incorporation by reference unless the complaining party has knowledge of the pertinent terms. Other authority prevents incorporation of terms not in existence at the time of the original assent, which might be described as “delinquent terms”—the postponement of creation of terms also might be used strategically to disadvantage a party. We now turn to selections from that authority.

below rightly refused to countenance for the insurers’ sole benefit an incorporation so ambiguous and so one-sided.” (Viscount Sumner).

47 E.g., Northrop Grumman Info. Tech., Inc. v. United States, 535 F.3d 1339, 1345 (Fed. Cir. 2008) (“[A] requirement that contract language be explicit or otherwise clear and precise does not amount to a rule that contracting parties must use a rote phrase or a formalistic template to effect an incorporation by reference.”); PartyLite Gifts, Inc. v. MacMillan, 895 F. Supp. 2d 1213, 1231 (M.D. Fla. 2012); In re Prudential Ins. Co. of America, 148 S.W.3d 124, 135 (Tex. 2004).


49 See, e.g., Bob Montgomery Chevrolet, Inc. v. Detor Zone Cos., 409 S.W.3d 181, 193 (Tex. App. 2013). The opinion holds that the lower court erred by incorporating extrinsic terms:

We conclude the referring language in this case, “Additional benefits, qualifications and details of the PDR LINX Service Program are available for your review at our website: http://www.linxmanager.com/pdf/CRC.TermsConditions.pdf,” does not indicate the parties intended to incorporate the internet document. Instead, the language indicates the internet document contained informative but noncontractual material about the PDR LINX Service Program.

Id. It is not clear what a “qualification” of the program would be, if not intended to alter the contractual relationship.

50 Peterson v. Residential Alternatives of Ill., Inc., 952 N.E.2d 1, 6 (Ill. App. Ct. 2010) (quoting Braeside Realty Trust v. Cimino, 133 Ill. App. 3d 1009, 1011 (Ill. App. Ct. 1985)) (“The rules of contract construction include a strong presumption against adding conditions or provisions that could have been easily included by the parties as terms of the contract, but were not.”).
It is sometimes said that contract terms are not incorporated by reference unless the offeree “had knowledge of and assented to the incorporated terms.” The principle is sometimes linked to the requirement that incorporated language is required to be identified adequately in the incorporating document.

Although this particular style for phrasing of the principles is typically expressed in opinions construing California law, it nevertheless appears to

51 E.g., PaineWebber Inc. v. Bybyk, 81 F.3d 1193, 1200–01 (2d Cir. 1996) (quoting Lamb v. Embhart Corp., 47 F.3d 551, 558 (2d Cir. 1995) (holding that the language “arbitration shall be governed by the rules of the organization convening the panel” was insufficient to incorporate by reference the limitations provision in the code governing the arbitral forum, the NASD). See also Taubman Cherry Creek Shopping Ctr., LLC v. Neiman-Marcus Grp., Inc., 251 P.3d 1091, 1095 (Colo. App. 2010) (quoting 11 SAMUEL WILLISTON & RICHARD A. LORD, A TREATISE ON THE LAW OF CONTRACTS § 30.25, at 234 (4th ed. 1999)) ("[F]or an incorporation by reference to be effective, ‘it must be clear that the parties to the agreement had knowledge of and assented to the incorporated terms.’"); Alpert, Goldberg, Butler, Norton & Weiss, P.C. v. Quinn, 983 A.2d 604, 618–19 (N.J. Super. Ct. App. Div. 2009) (holding statement in attorney retainer agreement that client would be bound “by our standard billing practices and firm policies” was ineffective to incorporate the policies by reference, both because they were not adequately identified and because “there was no indication that the terms of the proposed incorporated document were known or assented to by defendants”); Kuempel Co. v. Superior Sprinkler Co., No. C-840583, 1986 WL 6202, at *4–5 (Ohio Ct. App. June 4, 1986) (holding contractual reference in agreement formed October 1976 to the “latest edition” of form documents referred not to 1976 version published shortly before but to 1970 version, citing the requirement that incorporated document must be “known or easily available to the contracting parties”).

52 Richards v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 135 Cal. Rptr. 2d 26, 28–29 (Cal. Ct. App. 1997) (stating that “something more than a casual reference by incorporation is called for” in declining to enforce arbitration provisions under exchange rules putatively incorporated, referring to the ability to “change the ground-rules on a game-by-game basis,” and noting that “a mere inspection of this ‘agreement’ indicates that it probably was not meant to be read”).

53 E.g., Scott’s Valley Fruit Exch. v. Growers Refrigeration Co., 184 P.2d 183, 189 (Cal. Ct. App. 1947) (providing language oft-referenced in California: “For the terms of another document to be incorporated into the document executed by the parties the reference must be clear and unequivocal, the reference must be called to the attention of the other party and he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties.”), disapproved on other grounds by Hischemoeller v. Nat’l Ice & Cold Storage Co. of Cal., 254 P.2d 433, 439 (Cal. 1956). See also, e.g., Cardoso v. Local No. 1184 Laborers Intern. Union of N. Am., 154 F.3d 1072, 1074 (9th Cir. 1998) (quoting Slaught v. Bencomo Roofing Co., 30 Cal. Rptr. 2d 618, 621 (Cal. Ct. App. 1994)) (stating that the “incorporated document must be known or easily available to the contracting parties”); Kleveland v. Chicago Title Ins. Co., 46 Cal. Rptr. 3d 314, 316 (Cal. Ct. App. 2006) (“Incorporation by reference requires that (1) the reference to another document was clear and unequivocal; (2) the reference was called to the attention of the other party, who consented to that term; and (3) the terms of the
have a broader application. For example, authority quotes Corpus Juris Secundum to the following effect: “For the terms of another document to be incorporated into the document executed by the parties, the reference must be clear and unequivocal, and must be called to the attention of the other party, he must consent thereto, and the terms of the incorporated document must be known or easily available to the contracting parties; each case must turn on its own facts.”

A number of cases from other jurisdictions also reference the principle.

Riordan v. Doy provides an illustration from over 100 years ago. The opinion is written cryptically. In addition, reflecting an older style, some of the pertinent factual background appears only in headnote text. The case appears to involve the issue of whether contracts formed using a particular

incorporated documents were known or easily available to the contracting parties.”;


27 S.E. 939 (S.C. 1897).
code effectively incorporated standard terms, exchange rules, the code book indicates will be incorporated by reference. The court holds not.

The case involves futures contracts for cotton. There were statutory provisions at the time invalidating as unlawful wagering contracts agreements for future transactions in commodities that were not to be settled in kind. Extrinsic language allegedly incorporated by reference was proffered as relevant to whether the contracts were of the type prohibited.

The contracts were evidently communicated using a telegraph code, the book for which contemplated transactions communicated using the code would be subject to rules of a particular exchange. A headnote states the “telegraphic cipher code contains a note, ‘it is distinctly understood that all orders sent by this table are to be subject in all respects to the rules of the Cotton Exchange.’” The court holds the trial court correctly excluded the exchange rules from introduction into evidence, i.e., the use of the code did not incorporate the provisions of the exchange’s rules. The basis of the holding is reference to the extrinsic provisions was not sufficiently patent:

The fact that some reference was made to them in Shepperson’s Telegraphic Cipher Code, which seems to have been furnished to the defendant, cannot affect the question, for such reference did not disclose the scope or purport of the rules and by-laws of the New York Cotton Exchange. If the parties dealing with the defendant desired or expected the defendant to be governed by such rules and by-laws, it was their duty to have brought their provisions to his attention, which does not appear to have been done.

Delinquent Terms. Authority often states an extrinsic document is not effectively incorporated unless it is “adequately identified”—sometimes

57 Id. at 940.
58 Id. at 939 (headnote). Bibb v. Allen, 149 U.S. 481 (1893), a case involving a transcription error in use of the code, describes the code as to a similar effect, suggesting the headnote in Riordan can be taken as accurate.
59 Riordan, 27 S.E. at 943.
60 E.g., City of Meridian v. Petra Inc., 299 P.3d 232, 242 (Idaho 2013). Cf. Northrop Grumman Info. Tech., Inc. v. United States, 535 F.3d 1339, 1345 (Fed. Cir. 2008) (“[T]he language used in a contract to incorporate extrinsic material by reference must explicitly, or at least precisely, identify the written material being incorporated and must clearly communicate that the purpose of the reference is to incorporate the referenced material into the contract (rather than merely to acknowledge that the referenced material is relevant to the contract, e.g., as background law or negotiating history).”).
requiring the extrinsic language be "identified beyond all reasonable doubt."\(^{61}\)
This principle can be a basis under which terms of a document not yet in existence can be held not to be incorporated by reference.\(^{62}\) The failure to identify the putatively incorporated document in a way that facilitates locating it has been found relevant to determining the attempted incorporation ineffective.\(^{63}\)

A merchant seeking to obtain contractual consumer terms that could not be bargained-for expressly might proffer unreasonable terms incorporated by reference from some poorly identified extrinsic document or some document to be generated later. This would be with a view to increasing the consumer's cost of identifying the terms, i.e., increasing the associated friction. This authority, which limits the efficacy of those acts that may increase frictions, supports the notion that contracting with documentation formulated in a way


\(^{62}\) Randolph Const. Co. v. Kings East Corp., 334 A.2d 464, 467 (Conn. 1973) ("It may be argued that a contract which incorporates nonexisting documents is valid on the condition that the documents be in existence before either party attempts to enforce performance; 4 Williston, Contracts (3d Ed.) § 581; and in some instances, the law will uphold performance requirements beyond those apparent in the plans or specifications of a building contract. Where the specifications are altered, however, without the knowledge or understanding of the party to be bound, or when the documents on which the knowledge of one party is based are incomplete, so that the parties do not share a mutuality of assent, the contract as written will be held invalid." (citation omitted)).

that increases frictions, such as by needlessly increasing the cost of locating
the incorporated language, may be relevant in determining the attempted
incorporation ineffective.

The facial similarity between this authority and the modern rolling contracts
theory is deceptive. The rolling contracts theory refers to a situation under
which an understanding is formed through a vignette involving one party’s
delayed delivery of additional terms, after which delivery the recipient would
have some time to reject and return, postponing contract formation.64 The
rolling contracts approach to contract formation allows a party to take
advantage of frictions to secure better terms. The recipient of the terms will
not review them unless the expected benefit (from identifying any inferiority
of the terms) exceeds the convenience cost of review plus identification of a
substitute and the cost to return. The result is that if the convenience costs
exceed the anticipated benefits from review, the suboptimal terms control.
On the other hand, the result of the various authority discussed above is a
contract is formed with the proffered, onerous terms eliminated. The impact
is the opposite of that of the rolling contracts approach to contract
formation.

The primary point being made here is there is a collection of authority
supporting the notion that there is a reasonableness limit on incorporation
into a contract of extrinsic terms. That is not to say the authority is universal,
or even the talismanic “majority” approach. Nevertheless, there is a material
amount of authority to that effect. It is sufficient to provide a basis on which
a court can, in a fashion plausibly consistent with other long-standing
authority, incorporate reasonableness limits on the effectiveness of
incorporation of extrinsic terms.

Over time, technology has facilitated modes of contracting that were
more difficult or even impossible previously. A mere computer click can
purport to operate to accept terms located remotely of limitless length.

The point of following precedent is to provide consistent principles
governing disputes. As the common law was developing, centuries ago, the
technology then-available was at times used in attempts to secure assent to
latent terms. Problems were occasionally recognized judicially, and a number
of courts articulated principles restraining the problematic conduct.
Technology has made that undesirable conduct more practicable. It is not
inconsistent with the notion of precedent to rely increasingly on principles

64 Authority discussing the controversial analysis is voluminous. See, e.g., John E. Murray, Jr.,
The Dubious Status of the Rolling Contract Formation Theory, 50 D U Q. L. REV. 35 (2012), for an
eminent commentator’s recent contribution to that literature.
that were formerly referenced less frequently, when technological or other societal developments have made the problematic conduct more common. Regardless of whether authority such as *Riordan v. Doty* was formerly in vogue, it is consistent with the principles of precedent to turn to that authority as the misconduct that authority operates to restrain becomes more frequent.

One supposes contemporary courts seeking to revive the approach of *Riordan* and the other authority discussed above could do so in two ways. They could reinvigorate and directly rely on that authority, as a manner for the court exclude from the bargain assorted proffered terms attempted to be incorporated. On the other hand, a more limited step would be simply to make it a question for the fact-finder whether the extrinsic terms were part of the bargain. The current edition of Williston asserts, “[W]hether material has been incorporated presents a question of law.” However, the general trend is to return to the jury these kinds of questions that courts formerly, reflecting distrust of juries, kept for themselves. So, it would be consistent with the general trend in contract law also to allocate this determination to a fact-finder.

**B. Silence as Acceptance**

The law governing whether silence can operate as an acceptance provides a second circumstance where the broad-brushstroke statement of contemporary principles can easily elide pertinent authority that would support decisions inhibiting opportunistic use of frictions to secure beneficial contract terms. Consider the delivery of unsolicited goods. Absent the intervention of judicial principles, a vendor might seek to obtain sales that otherwise would not be made by delivering unsolicited goods and then billing for them. A recipient’s misapprehension of the law governing assent—a matter that may be costly to investigate—could produce some sales, with grudging assent that otherwise would not be obtained.

Absent judicial intervention, this approach to securing beneficial, but collectively suboptimal, contractual terms might show particular promise for—and seem particularly successful in—consumer contracts where marginal cost to fulfilling any particular contract is low. For other contracts, a

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merchant might increasingly hesitate to render unsolicited valuable items without a preexisting contract, fearing that a contract would not be formed. But if the performance costs little or nothing, the strategy might be more remunerative. Unfortunately, existing doctrine, at least in its rudimentary form, seems not well-suited to restraining this type of opportunistic strategy in circumstances where it has increased promise—the opportunistic delivery of services or intangibles.

The delivery of unordered merchandise, other than free samples and merchandise mailed by a charity, is categorized by federal statute as an unfair trade practice, which the recipient may treat as a gift. Some judicial interpretations of this brief statutory language are consistent with recognizing the importance of frictions. Thus, Blakemore v. Superior Court holds the statute does not regulate mailing of unordered merchandise “to independent jobbers or wholesalers or, as in this case, where a contractual relationship exists between the parties relating to the sale of the merchandise.” The outcome is not based on language in the statute expressly exempting those sales. Rather, it follows from the perceived purpose of the statute, as reflected in legislative history. On the other hand, a variety of authority declines to extend these protections to transactions not involving physical merchandise, such as a check sent as part of an unsolicited offer to extend credit and a membership kit for a rewards or discount program, where the court states, “[T]he Unordered Merchandise Statute governs only merchandise, and not everything that can be mailed falls within this category. In Kipperman, intangibles evidenced by written materials—there, an insurance policy or, arguably, an offer to sell insurance—were not found to be ‘merchandise’ as contemplated in the Statute.”

Consumer transactions increasingly involve intangibles (software or other services), which may not be embodied in a physical form. In such a case—

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69 Id. at 888.
71 Sanford v. Memberworks, Inc., No. 02CV0601-LAB (JFS), 2008 WL 4482159, at *11–13 (S.D. Cal. Sept. 30, 2008). See also Sanford v. MemberWorks, Inc., 625 F.3d 550, 559–60 (9th Cir. 2010) (stating memberships in discount programs are not merchandise; referencing prior authority as indicating merchandise is generally tangible).
offers having an intangible subject matter— the statute, as interpreted, would leave to the common law determination of whether the recipient’s subsequent actions operated as an assent to proposed contract terms. As the Corbin treatise notes, however, the statutory treatment is inconsistent with the common law approach, under which use of the unordered merchandise would operate as an acceptance of the proposed contract terms. The treatise notes this treatment is an alternative to classifying the offeree as one who has tortiously converted the property. The treatise describes the common law approach as “particularly outrageous[] where the goods are sent as a deliberate selling tactic thus unfairly exploiting the purposes for which the rule was originally created. Legislation has been enacted in an effort to curtail such abuses. Outside of this abusive area, the ancient rule continues unmodified.”

Technological developments have increased the importance of contracting outside the scope of these federal regulations. The question arises whether the final conclusion of the Corbin treatise is compelled by existing authority—whether only by making a complete break with existing common law authority could a court take the view that assent to proffered terms accompanying unsolicited intangibles or services is given by much conduct short of complete failure to deal with services or intangibles. As it turns out, there is some precedent that might be serviceable to this end.

The normal treatment at common law is the duty to act in good faith arises after contract formation; it does not appertain to contract formation.

In some cases there may be issues of line-drawing, as to whether the item, even if in physical form, primarily involves an intangible. See generally UMG Recordings, Inc. v. Augusta, 628 F.3d 1175, 1181 (9th Cir. 2011) (delivery of promotional compact disks containing music covered by the act); F.T.C. v. Think All Publ’g, L.L.C., No. 4:07-CV-11, 2007 WL 173854, at *2 (E.D. Tex. Jan. 19, 2007) (treating software on a compact disk as covered).

Understanding that the statute proscribes “mailing,” exclusion from the statutory regulation also may arise for arrangements involving services or intangibles not mailed.

1 Arthur Linton Corbin, Corbin on Contracts § 3.21 (Joseph M. Perillo ed., rev. ed. 1993).

Id at 422–24.

Id at 424.

E.g., Feldman v. Allegheny Int’l, Inc., 850 F.2d 1217, 1223 (7th Cir. 1988). See generally Friedrich Kessler & Edith Fine, Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study, 77 Harv. L. Rev. 401, 401 (“The common law appears to have no counterpart to the German doctrine of culpa in contrahendo: that contracting parties are under a duty, classified as contractual, to deal in good faith with each other during the negotiation stage, or else face liability, customarily to the extent of the wronged party’s reliance.”).

Yet, in a variety of circumstances, the rule that silence does not operate as an
assent yields where a party acts opportunistically. *Russell v. Raynes Associates
Ltd. Partnership* involves an offer made by an estate to participate in a
cooperative conversion. A combination of a minimum percentage of
residents being required to make the conversion effective, coupled with issues
as to the ability of an estate to participate, evidently created the possibility that
the sponsors might strategically decline to reply promptly to a tendered offer
by the estate. The court holds it is a question of fact as to whether the
sponsor’s silent retention of the offer operated as an acceptance:

Certainly, where a party remains silent with the purpose of misleading
the other party, such silence is “inconsistent with honest dealings and
... may be deemed to be an acquiescence.” Thus, in this case, if
Sponsors deliberately remained silent in order to retain the agreement
only so long as it was necessary to help in achieving the requisite
15%, their silence would constitute an acceptance.\(^7\)

In addition, as the Corbin treatise notes, a number of old cases hold
silence of an offeree who engaged a third party to solicit offers may operate as
an acceptance. The court in *Hendrickson v. International Harvester Co. of America*,
indicating the rule it adopts is in accord with case law in three other
jurisdictions, states:

And true it is that it is frequently said that one is ordinarily under no
obligation to do or say anything concerning a proposition which he
does not choose to accept; yet we think that, when one sends out an
agent to solicit orders for his goods, authorizing such agent to take
such orders subject to his (the principal’s) approval, fair dealing and
the exigencies of modern business require us to hold that he shall
signify to the customer within a reasonable time from the receipt of

\(^{\text{79}}\) *Id. at 414–15* (quoting *Club Chain of Manhattan, Ltd. v. Christopher & Seventh Gourmet,
\(^{\text{80}}\) *Corbin, supra* note 74, § 3.21, at 418.
the order his rejection of it, or suffer the consequence of having his silence operate as an approval.\textsuperscript{81}

So, Hendrickson supports the notion that the context can alter the otherwise traditional rules governing whether assent has been given in the absence of verbal communication. Hendrickson and Russell involve determinations where the context increases the scope of circumstances where assent exists. Understanding authority indicates the context can change the treatment, it would seem also to be the case that the context may decrease the extent to which actions constitute assent. The opportunistic transmission of unordered intangibles or services, with a view to benefitting from frictions to achieve favorable terms, would seem at least as compelling a basis for deviating from the normal treatment as the business exigencies, arising from the order of farm equipment, alluded-to in Hendrickson.

Weishut v. Layton & Layton, a case involving a battle of forms as to the timing of performance, holds a trial court did not err in charging a jury that an offeree may have had a duty to notify the offeror that the offeree did not assent to the altered term, so that silence could operate as an assent to a contract on altered terms. The approved charge was as follows:

Where one party makes a definite offer for the sale of a commodity before a contract results therefrom there must be an acceptance of the offer, by the other party, absolute and identical with the terms of the offer.

Ordinarily silence on the part of the party to whom the offer is made will not constitute an acceptance, but there may be instances where under all the facts and circumstances there is a duty imposed by law on the part of the party receiving the offer, to inform the person making the offer that the same is not accepted, and when this legal duty is found to exist, a failure in its performance will result in a contract equally binding on both parties.

Where there is an agreement and the language of the agreement is doubtful in meaning, that meaning is to prevail against either party which he knew or had reason to believe that the other party understood it.

If you should believe from all the evidence, that under all the facts and circumstances there was a duty upon the defendant to

\textsuperscript{81} Hendrickson v. Int'l Harvester Co. of Am., 135 A. 702, 705 (Vt. 1927).
communicate to the plaintiff the fact that it did not accept the terms contained in the plaintiff's telegram and letter dated June seventeenth, and it failed in this duty, then you may find that the parties to the action did enter into the contract sued upon in this action.\textsuperscript{82}

Moreover, other authority indicates that whether the terms are unusual is relevant in making these determinations. \textit{Harris v. Santee River Cypress Lumber Co.} affirms the findings of a bench trial that retention of an order did not operate as an acceptance where the order was on unusual terms (a very large order at a low price).\textsuperscript{83} Thus, we have extant authority supporting both the notion that ordinary principles governing non-verbal assent to an offer can yield based on the context and that the nature of the terms can also be considered in applying the principles governing assent.

\section*{C. Tickets and other Tokens Providing Contract Terms}

Consider whether words printed on a ticket or stub can constitute contractual terms. Contemporary courts have a number of common paths for concluding not. The direct approach would be to apply unconscionability, though litigants proposing that course are typically unsuccessful.\textsuperscript{84} The direct approach of unconscionability, policing the bargain based on the way it was formed, may appear noxious to a long-standing conceptualization of freedom of contract. It is contemporaneously supplemented by approaches treating tickets or stubs\textsuperscript{85} as not appearing to memorialize contract terms—memorably phrased as language that “did not arise to the dignity of a contract”\textsuperscript{86}—or as being ineffective by virtue of having been delivered after the contract has been formed.

\begin{thebibliography}
\bibitem{83} Harris v. Santee River Cypress Lumber Co., 72 A. 392, 393 (R.I. 1909).
\bibitem{84} For example, a relatively recent survey finds only a handful of reported cases in a particular jurisdiction, Missouri, where courts find contractual provisions unconscionable. Royce de Rohan Barondes, \textit{The Contours of the Unconsionability Defense in Missouri} (Univ. of Missouri–Columbia Sch. of Law Legal Studies, Research Paper No. 01, 2007), available at http://papers.ssrn.com/sol3/papers.cfm?abstract_id=955960.
\bibitem{85} The court in \textit{Tanenbaum Textile Co.} v. Schlanger, 40 N.E.2d 225, 226 (N.Y. 1942), references similar treatment of an invoice: “But that is not this case. An invoice, as such, is no contract. An invoice is a mere detailed statement of the nature, quantity and the cost or price of the things invoiced.”
\end{thebibliography}
This form of contracting can reflect a conscious attempt to benefit from frictions in contract formation to secure contractual terms that might be more difficult to obtain were there express negotiation. Consider, for example, the assent to terms of ski tickets, which address an oft-litigated relationship.\textsuperscript{87} It surely takes less time to sell the tickets if the clerk need not recite a liability release before selling a ticket from a booth.

But increased efficiency in communication of terms is not the only advantage. It allows the seller (licensor) to avoid providing a venue in which a customer is prompted to consider the implications of the contemplated terms. That could be significant. The resort doesn't want to have to get into a discussion of this kind of matter. Having customers focus on the possible adverse consequences of the relationship or activity, in general, may have some effect on sales. But in addition, it may prompt disclosure of adverse circumstances that otherwise would not be disclosed.

If someone in a booth has to say that the resort will not be liable for customers' injuries, some customers may then be prompted to ask, in circumstances where they would not otherwise, whether there have been injuries at the resort. The resort would need to decide whether to have its employees refuse to comment, which may be taken by customers as providing negative information, or to have them address the matter accurately, and potentially communicate negative information. None of this will increase sales, but it may decrease them. So, to some extent, giving effect to these terms surreptitiously obtained may slightly alter the contractual arrangements that otherwise would be obtained were there express bargaining.

But it would be a mistake to claim old authority rejected direct review of the reasonableness of terms contemplated by language printed on a ticket. Over one hundred years ago, a Williston edition of \textit{Pollock on Contracts}, in addition to characterizing a ticket as "a mere token or voucher ... not the contract,"\textsuperscript{88} minimizing the impact of the writing on contract terms, states enforceability of these kind of terms "is probably subject to an implied condition that the terms are relevant and reasonable. It cannot be said that the subject is yet free from doubt."\textsuperscript{89}

\begin{footnotes}
\item[88] \textsc{Frederick Pollock}, \textit{Principles of Contract at Law and in Equity: Third American from the Seventh English Edition} 53 n.60 (Gustavus H. Wald & Samuel Williston eds., 1906).
\item[89] \textit{Id} at 54-55. The discussion there addresses contracts for carriage or custody of goods. \textit{See also id} at 55.
\end{footnotes}
That authority, by its terms, appears to address only contracts formed by common carriers or others with a common duty. Nevertheless, it is an application of principles of contract. As the annotation notes, the law at that time provided those parties were under implied duties that could not be eliminated by mere notice. “[I]t requires no contract to create these; it does require one to divest them.”

A similar approach is taken in *Los Angeles Inv. Co. v. Home Sav. Bank of Los Angeles*:

But it is evident that the statement comes in the category of ‘traps for the unwary,’ and before such statement can be given effect as a contract binding upon the depositor and changing in a substantial particular the relation which presumably he thought he was entering into, it must appear affirmatively that he consented and agreed to it either by being required to sign it or by having his attention particularly called to it. It is not sufficient merely that it appear in the front of the passbook. The case is not one in which the party must know that he is accepting a contract, as where he is accepting an insurance policy, and should therefore realize the necessity of acquainting himself with its terms.

We can frame as follows this authority that is summarized in *Pollock on Contracts*: The statutory provisions gave rise to a general expectation that contractual arrangements of a particular type would be governed by a particular set of rules—in that case, rules provided by statute. So, the expectation of contracting being on particular terms necessitates a particular level of prominence to alter those terms.

This treatment comports with the contemporary notion of frictions. Statutory provisions create an expectation contracting will be on particular terms, which one can frame as there being increased frictions associated with formation of assent. Consumers are less likely to be informed by communication that might be sufficient in other contexts—in other contexts where there are not standardized expectations. Where greater effort is required to assure there is actual assent, greater efforts are required in memorializing the pertinent terms.

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90 Id. 53 n.61.
CONCLUSION

A few decades ago, some scholars glibly asserted market forces would operate to eliminate collectively inferior ancillary contract terms. Over time, there has been some retreat from that bold view. Building on the development of modeling frictions in markets, this article presents simple models of frictions in multi-period contracting, incorporating frictions preventing switching and limited dissemination of information concerning ancillary contract terms. The modeling illustrates that, for plausible parameter estimates of frictions, combinations of switching costs and investigation costs may allow collectively inferior contract terms to persist in consumer transactions. The results expand on recent evidence illustrating the infrequency with which consumers actually read contract terms.

The modeling results are likely consistent with one’s intuition. The modeling, then, provides a more formal basis for rejecting the glib assertion that market forces would eliminate collectively inferior ancillary contract terms.

Merchants, particularly in consumer contracting, might well be inclined to engage in opportunistic behavior, framing assent in a fashion that allows these frictions apparently to secure contract terms superior for them, albeit collectively suboptimal. The modeling identifies classes of circumstances where this opportunistic behavior is particularly likely to be successful in securing beneficial, but collectively suboptimal, terms. They include: (i) contracts of a small dollar amounts, whether in terms of value of consideration or marginal cost in performing; (ii) contracting involving the sequencing of relationship-specific investments during contract formation; (iii) multi-period contracting, especially where involving increasing switching costs; (iv) merchants who sell to pools of customers involving new customer entrants over time, including rapidly growing markets; and (v) circumstances where one proffering suboptimal terms may bifurcate contractual terms, providing better terms to informed customers. One can see that a number of these factors are common to the provision of online services.

A primitive conceptualization of contract doctrine might suggest that courts, cognizant of these concerns, are nevertheless compelled to give effect to this opportunistic behavior, until it crosses the threshold of gross misconduct restrained by fraud or unconscionability. Part V of this article provides contrary illustrations. In lieu of providing a comprehensive collection of authority, which would be much too large an undertaking, Part V provides illustrations of selected authority that can be revived by a court
inclined to police opportunistic structuring of the methods of mutual assent to secure collectively suboptimal contract terms. Focusing merely on common law authority addressing incorporation by reference, silence as acceptance and the use of tickets and other tokens to provide contract terms, Part V illustrates the wealth of authority that a court may reference in seeking to return sufficient nuance to contract doctrine to restrain this kind of opportunism.
Fig. 2. Flow Chart Illustrating Steps Modeled in Part II
APPENDIX II

Let us define:

- \( M_{b0} \): the number of market participants with Bad (inferior) terms at the beginning of Time Period 0
- \( M_{b0\text{NoSwitch}} \): the number of market participants with inferior terms at the beginning of Time Period 0 who cannot switch
- \( \eta \): the market growth rate per period (expressed as a fraction/decimal)
- \( \alpha \): the attrition rate from Bad to Good, of those who can switch
- \( \psi \): the fraction of incumbents who can switch from Bad to Good at the beginning of the current period who become unable to switch in the current period (no switch fraction)

Those who become unable to switch during Time Period 0 equals: \( M_{b0} - M_{b0\text{NoSwitch}} \). Thus, the clients who switch is represented by:

\[
\alpha \left( M_{b0} - \left( M_{b0\text{NoSwitch}} + M_{b0} \psi - M_{b0\text{NoSwitch}} \psi \right) \right), \text{ or } \\
\left[ \alpha (1 - \psi) (M_{b0} - M_{b0\text{NoSwitch}}) \right]
\]

This yields a new inflow rate, stated as a fraction of those having inferior ancillary terms as of the beginning of Time Period 0, to merchants having Bad terms of:

\[
\text{inflow rate} = \eta + \alpha (1 - \psi) \left( 1 - \frac{M_{b0\text{NoSwitch}}}{M_{b0}} \right)
\]

(1)

The term \text{inflow rate} represents a fraction that, when multiplied by the number of clients having Bad terms at the beginning of the period, is the number new market entrants in that period that must be captured by those offering Bad terms to maintain a steady state. For example, a required inflow rate of 0.15 means that, in the period, new market entrants having Bad terms must equal 15% of the number of market participants having Bad terms at the beginning of the period.
During Time Period 1, the number of clients who cannot switch equals:

(i) the number who cannot switch at the end of Time Period 0 plus
(ii) \( \psi \) (the no-switch rate) multiplied by the number of market participants at the end of Time Period 0 having Bad terms who can switch.

We have from above that (i) equals:

\[ M_{b0 \text{NoSwitch}} + \left[ M_{b0} - M_{b0 \text{NoSwitch}} \right] \psi, \] or

\[ [M_{b0} \psi + M_{b0 \text{NoSwitch}} (1 - \psi)] \]

Understanding that the market size of those having Bad terms at the end of Time Period 0 is \( M_{b0} (1 + \eta) \), we have that (ii) equals:

\[ \psi \left\{ M_{b0} (1 + \eta) - [M_{b0} \psi + M_{b0 \text{NoSwitch}} (1 - \psi)] \right\}, \]
yielding the number having Bad terms who cannot switch during Time Period 1 equals:

\[ [M_{b0} \psi + M_{b0 \text{NoSwitch}} (1 - \psi)] + \{M_{b0} (1 + \eta) - [M_{b0} \psi + M_{b0 \text{NoSwitch}} (1 - \psi)]\} \psi \]

This can be simplified to:

\[ [M_{b0 \text{NoSwitch}} (1 - \psi)^2] + M_{b0} \psi (2 - \psi + \eta) \]

That means those who switch equals:

\[ \alpha \left\{ M_{b0} (1 + \eta) - [M_{b0 \text{NoSwitch}} (1 - \psi)^2] + M_{b0} \psi (2 - \psi + \eta) \right\} \]

which simplifies to:

\[ \alpha (1 - \psi) \{ M_{b0} [(1 + \eta) - \psi] - [M_{b0 \text{NoSwitch}} (1 - \psi)] \} \]

Understanding the inflow has to equal \( \eta \) plus the attrition, that equates to an inflow rate (as a fraction of the period-beginning number of market participants having inferior terms) of:

\[ \text{inflow rate} = \eta + \alpha (1 - \psi) \left[ 1 - \frac{M_{b0 \text{NoSwitch}}}{M_{b0}} - \frac{[M_{b0} \psi - M_{b0 \text{NoSwitch}} (\psi)^2]}{M_{b0} (1 + \eta)} \right] \quad (2) \]
When:

\[ M_{b0} \psi - M_{b0\text{NoSwitch}}(\eta + \psi) = 0, \]

the model reaches a steady state, such that the rate of inflow is constant (the rate of inflow in Time Period 0 is the same as in Time Period 1 (Equations (1) and (2)). We can restate this criterion as:

\[ \frac{M_{b0\text{NoSwitch}}}{M_{b0}} = \frac{\psi}{\eta + \psi} \tag{3} \]

Substituting the fraction of customers who cannot switch, as of the beginning of the period, in steady-state, from Equation (3), into the formula for the inflow rate of new clients into those having Bad terms from Equation (1), we get the following steady-state inflow rate when there are switching costs:

\[ \eta + \alpha \left( 1 - \psi \right) \left( 1 - \frac{\psi}{\eta + \psi} \right) \]

Rearranging yields:

\[ \text{steady state inflow rate (fraction of Bad)} = \eta \left( 1 + \alpha \frac{1 - \psi}{\eta + \psi} \right) \tag{4} \]

which can be restated as:

\[ \text{steady state inflow rate (fraction of Bad)} = \eta \left( 1 + \frac{\alpha \eta (1 - \psi)}{\eta + \psi} \right) \tag{5} \]
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