

# THE HIDDEN ROLES OF BOILERPLATE AND STANDARD-FORM CONTRACTS: STRATEGIC IMPOSITION OF TRANSACTION COSTS, SEGMENTATION OF CONSUMERS, AND ANTICOMPETITIVE EFFECTS

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## INTRODUCTION

Standard-form contracts offered to consumers contain numerous terms and clauses, most of which are ancillary to the main terms of the transaction. We call these ancillary terms “boilerplate provisions.” Since most consumers do not read boilerplate provisions or, if they do, find them hard to understand,<sup>1</sup> courts are suspicious of boilerplate provisions and sometimes find them unenforceable under the doctrine of unconscionability.<sup>2</sup> At times, courts conclude that harsh terms have not been accepted by consumers in the first place and therefore are not included in the contract,<sup>3</sup> and on

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1. See, e.g., Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 HARV. L. REV. 1174, 1177, 1179 (1983) (“Virtually every scholar who has written about contracts of adhesion has accepted the truth [that the adhering party is in practice unlikely to have read the standard terms before signing the document] . . . and the few empirical studies that have been done have agreed.”).

2. See U.C.C. § 2-302(1) (2005); RESTATEMENT (SECOND) OF CONTRACTS § 208 (1981); E. ALLAN FARNSWORTH, CONTRACTS § 4.28, at 308 (Aspen Law & Bus. 3d ed. 1999).

Courts could also declare harsh terms unenforceable when such terms are against public policy. RESTATEMENT (SECOND) OF CONTRACTS §§ 178–99, 211 cmt. c (1981). Such terms are also subject to the overriding obligation of good faith. *Id.* at §§ 211 cmt. c, 205.

3. See RESTATEMENT (SECOND) OF CONTRACTS § 211(3) cmts. b, c (noting instances where enforcement of terms is accepted by customers); see also FARNSWORTH, *supra* note 2, § 4.26, at 298–300. For the various legal tools used to handle harsh terms in standard-form contracts, including the “reasonable expectation” doctrine, see Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 456–60 (2002).

other occasions courts interpret boilerplate provisions in favor of consumers, applying the rule of interpretation against the draftsman.<sup>4</sup>

There is ample legal writing discussing the justification for legislatures' and courts' intervention in consumer standard-form contracts.<sup>5</sup> Most law and economics scholars agree that striking down harsh clauses included in boilerplate language could be justified when there is asymmetry of information—either factual or legal—between the supplier and consumers with respect to the harsh clause, which precludes consumers from fully understanding the effects of the clause on their legal rights.<sup>6</sup> In such cases, there is a risk that the supplier will extract payment from the consumer without the latter being aware of the fact that the payment does not reflect the reduction of value due to the harsh clause.<sup>7</sup> Thus, if an exclusionary boilerplate clause phrased in a sophisticated legal manner releases the supplier from liability for late delivery of goods, the consumer might not realize the full effects of such a clause or understand the very high price she might pay for it in the future.<sup>8</sup> If this risk is a substantial one, a court could be justified in striking down the clause. If, however, most consumers could reasonably understand the exclusionary clause and estimate its costs for them, a court's intervention would not be justified, since absent asymmetry of information there is no reason to suspect that incorporating the clause into the contract would be

4. RESTATEMENT (SECOND) OF CONTRACTS § 206 (1981); *see also* FARNSWORTH, *supra* note 2, § 4.26, at 300.

5. *See, e.g.*, Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 240–41 (1995) (stating that for the past forty years, contract scholars have been preoccupied with enforceability of preprinted contract terms); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 U. CHI. L. REV. 1203 (2003) [hereinafter Korobkin, *Bounded Rationality*] (arguing that the drafting parties will have a market incentive to include terms in their standard forms that favor themselves, whether or not such terms are efficient); Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608, 673–75 (1998) (suggesting that courts use nonenforcement default rules to force parties to fill contractual gaps); Eric A. Posner, *Contract Law in the Welfare State: A Defense of the Unconscionability Doctrine, Usury Laws, and Related Limitations on the Freedom to Contract*, 24 J. LEGAL STUD. 283, 284 (1995) (“[T]he efficiency argument concludes that courts should enforce all voluntary contracts that do not produce negative externalities, regardless of their distributive consequences.”); Rakoff, *supra* note 1, at 1238.

6. Rakoff, *supra* note 1, at 1226 (“[T]he rational course is to focus on the few terms that are generally well publicized and of immediate concern, and to ignore the rest.”). *But see* Douglas G. Baird, *Commercial Norms and the Fine Art of the Small Con*, 98 MICH. L. REV. 2716, 2724 (2000) (“General rules governing the use of preprinted terms do little with respect to places where abuse is likely and too much where it is not.”).

7. *See* Steven P. Croley & Jon D. Hanson, *Rescuing the Revolution: The Revived Case for Enterprise Liability*, 91 MICH. L. REV. 683, 770 (1993) (“[T]he efficiency of consumer product markets depends upon consumers' ability to overcome information costs, for without full information consumers are unable to make consumption and warranty decisions that reflect their true preferences.”); Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics Meets the Real World*, 24 GA. L. REV. 583, 585 (1990) (“[I]mperfect consumer information causes a tendency toward inefficiency in transactions involving consumer form contracts.”).

8. Korobkin, *Bounded Rationality*, *supra* note 5, at 1217–18 (“Efficiency requires not only that buyers be aware of the content of form contracts, but also that they fully incorporate that information into their purchase decisions. Because buyers are boundedly rational rather than fully rational decisionmakers, they will infrequently satisfy this requirement.”).

inefficient.<sup>9</sup> On the contrary, when information is symmetric, both parties strive to incorporate efficient terms into their contract, terms that increase the surplus of the contract to the benefit of both parties.

In this Article, we argue that boilerplate provisions and standard-form contracts are used—or could be used—by suppliers for purposes other than the familiar one discussed above. Some of these uses are efficient and some are inefficient. What all these uses have in common is that their virtue to the supplier lies in the transaction costs imposed upon consumers, from which the supplier expects to gain.<sup>10</sup> However, in contrast to the familiar use of boilerplate provisions as creating asymmetry of information between the supplier and consumers, we discuss cases in which the asymmetry of information is not necessarily between the supplier and consumers, but rather between different kinds of consumers or between consumers and nonconsumers. We also discuss cases in which the supplier could gain from the transaction costs imposed on consumers even absent any kind of information asymmetries, as well as cases in which the transaction costs imposed by the supplier could be beneficial from a welfare perspective.

In the following paragraphs we summarize the four main categories of cases that are the focus of this Article, characterized by the different goals suppliers might try to achieve by imposing transaction costs on consumers.

In the first category of cases, the supplier uses boilerplate provisions and other contractual terms for segmentation of consumers. By creating transaction costs that some consumers are willing to bear while others are not, suppliers could achieve several goals. First, suppliers may want to transact with certain consumers but not with others. At times a supplier could use boilerplate provisions to screen out the unwanted consumers by imposing high transaction costs upon them, while at the same time keeping transaction costs low enough for other consumers. On other occasions, the supplier could use boilerplate terms to impose the same transaction costs on all consumers, expecting only the consumers he would like to transact with to incur these costs. Second, the supplier could use boilerplate provisions for price discrimination by conferring benefits only on consumers who read, understand, and remember certain boilerplate provisions. Third, the supplier may want to use boilerplate provisions to hide benefits conferred upon one group of consumers from the eyes of another group that did not receive these benefits. Fourth, boilerplate provisions could be a useful and reliable tool for suppliers for receiving information about consumers' preferences. Suppliers

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9. Michael I. Meyerson, *The Reunification of Contract Law: The Objective Theory of Consumer Form Contracts*, 47 U. MIAMI L. REV. 1263, 1299 (1993) (concluding that buyers should be bound only to those form terms that they "know and comprehend").

This is true regardless of the supplier's market power, since even a monopoly has no reason to include a harsh clause that reduces the supplier and the consumer's joint payoffs. See Richard Craswell, *Passing on the Costs of Legal Rules: Efficiency and Distribution in Buyer-Seller Relationships*, 43 STAN. L. REV. 361, 369 (1991); Korobkin, *Bounded Rationality*, *supra* note 5, at 1211–12.

10. The phrase "transaction costs" is used in this Article in the broader sense, to encompass not only information barriers, but also cognitive limitations. We recognize that in other contexts it makes sense to distinguish between the two, as demonstrated by Korobkin, *Bounded Rationality*, *supra* note 5.

could do so by monitoring the way in which consumers explore boilerplate language, given the transaction costs they need to incur in order to conduct such exploration.

In the second category of cases, the supplier uses boilerplate provisions for stabilization of cartels and obstruction of competition among suppliers. First, suppliers could use boilerplate language to make their contracts complex so that consumers would find it difficult to compare contracts of competing suppliers. Such complexity deters suppliers from deviating from explicit or tacit cartels, since consumers would have difficulty in comprehending that the price-cutting supplier is offering them a better deal. Complexity also tends to raise prices in oligopolistic markets even absent tacit or explicit cartels. Moreover, complexity could deter entry of new firms into the suppliers' market. Second, suppliers could use beneficial boilerplate provisions, available only to consumers who read, understand, and remember them, in order to facilitate the sustainability of tacit or explicit cartels. While collusion over harsh boilerplate provisions could relatively easily break down, collusion over the terms applied to nonreaders of boilerplate provisions, coupled with benefits granted to readers of these provisions, could be more sustainable, and at times, also more profitable. Third, suppliers could use beneficial boilerplate provisions, available only to readers of such terms who understand and remember them, as an anticompetitive signaling device. The beneficial provisions are a relatively credible and cheap signal of how efficient and competent the supplier is. Such a signal could discourage welfare-enhancing (unsuccessful) attempts by rivals to exclude the supplier and could also deter entry of new suppliers.

In the third category of cases the supplier tries to create a facade of a contract that is different than its true nature. Sometimes the supplier creates a facade of a fair contract by balancing harsh terms in the contract with beneficial terms hidden in boilerplate provisions. This facade can help immunize the contract from intervention by courts or administrative bodies or from public criticism. The supplier lowers his costs of granting the countervailing benefits by creating transaction costs that preclude many consumers from benefiting from these terms. Additionally, in some cases the supplier is concerned about criticism coming from nonparties for conferring far-reaching benefits to parties to the contract. By raising the transaction costs of nonparties and making it hard for them to understand the nature of the contract, the supplier may escape their criticism and related consequences.

In the fourth and last category of cases, standard-form contracts are used by the supplier to create self-inflicted transaction costs that credibly signal that the contract, or some of its terms, are not negotiable. This credible signal serves the supplier's interests in various contexts. In some contexts, the value of a beneficial term in the contract is contingent upon its non-negotiability. Sometimes the supplier may want to signal to each of his commercial buyers that the terms of sale granted to his other commercial buyers are not negotiable. This could help the supplier commit to not granting concessions to any of his buyers. Also, suppliers who participate in an implicit or explicit cartel may want to induce their rivals to participate as

well by making their own defections from the cartel more transparent. They can do so by adopting standard contracts and increasing their own transaction costs of secretly negotiating them with selected customers.

The various uses of boilerplate language and standard-form contracts to generate transaction costs raise the question of whether these uses are desirable from a social perspective. Some of the uses are desirable, while some are either undesirable altogether or undesirable under certain circumstances. While a comprehensive exploration of all of the policy implications of all of the above-mentioned uses of boilerplate and standard-form contracts is beyond the scope of this Article, we focus in detail on the policy implications of beneficial boilerplate provisions. In doing so we also discuss certain doctrines and principles taken from antitrust law, consumer law, contracts, and torts, and demonstrate how these doctrines and rules could be applied to cope with the harsh effects that beneficial boilerplate terms could cause.

This Article is organized as follows: in Parts I through IV we discuss in detail the various uses of boilerplate provisions and standard-form contracts, as represented by the four categories of cases summarized above. In Part V we evaluate beneficial boilerplate terms from a normative point of view, and discuss the attitude the law should take toward them.

## I. SEGMENTATION OF CONSUMERS

### A. *Screening Consumers Out*

Sometimes the supplier is not interested in transacting with all consumers but only with some consumer segments. She could use boilerplate language to screen out unwanted consumers by inflicting high transaction costs upon them, thereby making the transaction prohibitively costly for them. The supplier's desire to transact only with some consumers but not with others could stem from their different qualities, different abilities of performance, or any other characteristic that could affect the supplier's expected profits. As we will immediately see through the first hypothetical example, not all such uses of boilerplate provisions should be permitted by law.

*Example 1. Language.* Supplier offers apartments for rent in an urban place in Israel where most residents are Jewish. Supplier prefers not to transact with Arabs partly because his employees do not speak Arabic, but mainly because he believes that if he could keep the residency homogenous and Jewish, he would reap more profits from renting the apartments. This is because many Jewish people are reluctant to live in the same neighborhood as Arabs. Supplier offers his potential consumers a standard-form contract drafted in Hebrew, which most potential Arab consumers find hard to read and understand.<sup>11</sup>

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11. Similarly, English-speaking vendors and suppliers contract with non-English small-business owners primarily through the medium of English-language standardized forms. Julian S. Lim, Comment, *Tongue-Tied in the Market: The Relevance of Contract Law to Racial-Language*

Drafting the contract in Hebrew and conducting all negotiations in Hebrew, raises the transaction costs of people who do not read the language. The reason for using language as a screening device could be the supplier's racism or his assumption that the consumers he wants to attract are racists. Instead of explicitly refusing to transact with Arabs, which is prohibited by law and could damage the supplier's reputation, the supplier may find it less costly to discriminate implicitly by drafting and negotiating all contracts in Hebrew. Moreover, if criticized, the supplier could always argue that drafting and negotiating in Arabic requires him to hire Arabic-speaking employees or translators, resulting in high costs that are not economically justified, given the few potential Arab consumers.

The next example illustrates cases where the supplier wishes to particularly attract customers who make repeat transactions or large purchases. The reason could be, for example, that the supplier bears more transaction costs when he has to deal with many new customers, and he could economize on his transaction costs when he deals with experienced repeat purchasers. More generally, with large purchasers, the supplier does not have to recruit a multitude of customers in order to reach an efficient scale of operation and recoup his fixed costs.

*Example 2. Repeat Consumers.* Supplier offers sophisticated technical equipment for rent for short periods of time. Supplier prefers to serve only repeat consumers. Practically, he cannot charge the one-time consumers higher prices, either because the law prohibits discrimination on the basis of the quantity purchased,<sup>12</sup> or because it is hard to distinguish between the one-time consumers and the repeat consumers. Supplier could screen out the one-time consumers by making the initial transaction costs of renting equipment for the first time high enough that the transaction is worthwhile only for repeat consumers. The supplier can achieve this goal by complicating the boilerplate language of the standard-form contract and by complicating the contracting stage as a whole.<sup>13</sup>

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*Minorities*, 91 CAL. L. REV. 579, 586–90 (2003); see also Steven W. Bender, *Consumer Protection for Latinos: Overcoming Language Fraud and English-Only in the Marketplace*, 45 AM. U. L. REV. 1027, 1036 (1996) (“Although most merchants will not affirmatively misrepresent their deals to the Spanish-Only Consumer, many merchants will transact business with them partially or entirely in English.”).

12. According to Section 1(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a) (2000), “[i]t shall be unlawful . . . to discriminate in price between different purchasers of commodities of like grade and quality . . . where the effect of such discrimination may be . . . to injure, destroy, or prevent competition with any person who . . . knowingly receives the benefit of such discrimination.” This section has been interpreted to prohibit quantity discounts granted to large commercial buyers—discounts which small commercial buyers cannot enjoy due to their limited demand—unless they are justified by different costs involved in selling different quantities. See *Fed. Trade Comm’n v. Morton Salt Co.*, 334 U.S. 37 (1948).

13. Illustrative are the registration forms of Internet web sites offering services free of charge. In order to become a member of such web site, the user must fill out various registration forms. As part of the registration process, the web site sends authentication messages to the user's email address and the user has to confirm their receipt to activate his membership. One of the reasons for such requirements could be the imposition of additional transaction costs in order to screen out one-time users. See, e.g., DriverGuide, Join for Free, <http://members.driverguide.com/ums/index.php> (last visited Dec. 2, 2005).

In Example 2, the boilerplate language, standard-form contracts, and paperwork create artificial barriers for consumers entering into the contract. Only consumers who expect to gain high enough profits will incur the transaction costs, and typically those will be the repeat consumers. Note that if a one-time consumer enters into the contract after all, we assume the supplier would not be able to extract a higher price from him. If he could do so, it would be a case of quantity discounts.

The creation of high transaction costs in order to screen out one-time consumers is a very common phenomenon. Thus, consumer membership clubs linked to the supplier's store or chain of stores are beneficial to the supplier only when repeat consumers are concerned, since the administrative costs of adding a member to the club could be higher than the expected profits the supplier could make on a one-time consumer. Increasing the consumers' transaction costs in joining the club by asking them to read and fill out long and time-consuming documents and forms could be a practical way to screen out one-time consumers.<sup>14</sup>

Screening out small *commercial* buyers could also be desirable to some suppliers. Suppliers can do so by imposing transaction costs that are high enough to deter small buyers from entering the contract. If a small grocery store, for example, needs to fill out complex forms and questionnaires each month in order to buy from the supplier, it may switch to a different supplier who does not impose such transaction costs. A large- or medium-sized supermarket chain, on the other hand, may find such transaction costs negligible compared to the volume of their business with the supplier.

One may ask why suppliers often screen out one-time or small customers by imposing transaction costs rather than by using a subscription fee or other fixed payment that would be prohibitive for one-time or small customers but worthwhile for repeat or large purchasers. After all, while transaction costs constitute a net loss to both sides of the contract, a subscription fee increases the supplier's revenue. One reason could be that with subscription fees, customers may suspect that the supplier is using the subscription fee to make additional profits at their expense and may therefore prefer a compet-

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14. Another example is found in a new service offered by Visa in Israel. The credit card company issues credit cards to minors (called Y cards), and limits the credit to a few hundred shekels that the minor's parent transfers in advance to the minor's credit account. See Ycard, <http://www.ycard.co.il> (Israeli web site). In order to issue the card, the minor (and his parent) need to fill out long forms and also bring them in person to the bank. We speculate that if the transaction costs had been very low, many minors would have applied for the credit card without considering seriously enough whether they really intend to use it. By raising transaction costs, Visa ensures that applicants, before applying for the card, will give it a second thought. This way, the credit card issuer saves its costs of issuing a card to minors who do not really intend to use it.

Another example is the members club "The University Book Store," which offers house charge accounts to those who find it easier and who qualify," and promises its members "no annual fee; Low credit card interest on your revolving credit balance; Special promotions available only to University Book Store credit card holders." In order to become a member, the customer has to fill in a time-consuming enrollment form, print it out, and send it by post-mail. See University Book Store, Customer Service, <http://www.bookstore.washington.edu/services.taf?dept=about&category=services&par=services&ttl=services>. A similar practice is used by "frequent buyers" clubs. See, e.g., Duty Free Stores New Zealand, <http://www.dutyfreestores.co.nz/Frequent%20Buyer%20Club> (last visited Jan. 30, 2006).

ing supplier, who screens out one-time customers via transaction costs rather than via subscription fees.<sup>15</sup> Another reason is that the supplier would often like to make the subscription fee smaller for large customers than for small customers, in order to be attractive to large customers.<sup>16</sup> For practical reasons, however, it would be hard for the supplier to charge different subscription fees to different consumers. When using transaction costs, the supplier could often achieve such discrimination in favor of large customers since large customers often find the transaction costs less burdensome than small customers do. For example, a large supermarket chain could assign one of its various employees the task of specializing in the paperwork required by various suppliers. The owner of a small grocery store, on the other hand, would have to spend his own valuable time on going through such paperwork.

Another method for screening out small or one-time customers is through quantity discounts. Recall, however, that these depend on the supplier being able to distinguish between small and large buyers. Furthermore, when small and large commercial buyers compete with each other, quantity discounts are generally prohibited.<sup>17</sup>

In other cases, the supplier is concerned about “risky” consumers, who would not fulfill their part of the deal or would otherwise burden the supplier. Ideally, the supplier could charge them higher prices or collect damages from them when they fail to perform their part of the contract. Practically, however, requiring consumers to pass the test of high transaction costs could often be a better choice. This practical solution would be more attractive than the other alternatives when consumers’ defaults are unobservable or unverifiable, when the expected damages from the defaults are too low to justify litigation, or when it is impractical to charge more risky consumers higher prices, for example, because it is impossible to identify them in advance as risky. Examples of such cases are short-term employment contracts and short-term rental contracts.<sup>18</sup> In both types of cases, it is hard for the supplier to predict which employees or consumers are risky, in the sense that they might change their minds and defect, either before performance

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15. One could claim that a subscription fee does not necessarily deter consumers because it allows the supplier to charge lower prices per unit. This claim does not always hold, however. For behavioural reasons, and also due to lack of sufficient information, consumers cannot accurately calculate the value of their time in bearing the transaction costs imposed by the supplier. They are aware, however, of the fact that a subscription fee can be used by the supplier to extract surplus from them and transaction costs cannot. Accordingly, they may prefer a supplier who screens out using transaction costs to a supplier who screens out using a subscription fee and charges the same price per unit as the first supplier. See Darren Duxbury et al., *Mental Accounting and Decision Making: Evidence Under Reverse Conditions Where Money is Spent for Time Saved*, 26 J. ECON. PSYCH. 567 (2005) (stating that individuals irrationally tend to value money more than they value time).

16. Large customers enjoy the benefits of such discrimination not only directly, but also indirectly, since the quality of the supplier’s services could be enhanced when small customers are excluded.

17. See *supra* note 12.

18. For example, see the sophisticated application form and the rules and regulations that must be followed in order to enroll in Educational Housing Services in New York. See Educational Housing Services, <http://www.studenthousing.org/> (last visited Dec. 2, 2005).

starts or a short while thereafter, leaving the supplier with unrecoverable losses. The following example is illustrative of such cases:

*Example 3. Short-term Employment.* Supplier is a fast-food chain that hires unprofessional manpower for various tasks. Supplier realizes that very often employees quit a few days following commencement of employment, after the supplier has invested efforts in training them for the job. For practical reasons, the supplier can neither charge them for its costs when they quit, nor charge them in advance when hired.<sup>19</sup>

As we have explained, conditioning employment upon incurring high transaction costs could be a practical technique for screening out employees who are not certain whether they want the job or not. Asking potential employees to fill out long forms and requiring them to sign detailed contracts that require costly legal consulting could serve as a guarantee that the potential employee is serious enough about the job. Notice that while it is relatively easy to verify the employees' competence for the job, it is much harder to verify their willingness to persist in the job for a long period of time.<sup>20</sup>

We conclude this section with a (wild?) speculation about the submission process conducted by top U.S. Law Reviews. We have noticed that most top law reviews in the United States condition submission of a paper upon mailing a hard copy to the law review in addition to an electronic version that should follow.<sup>21</sup> The hard-copy requirement could create transaction costs that would screen out writers that may be thought of as less likely to succeed in their submission. Such screening out would save the law reviews costs and time. Writers for whom the hard copy requirement creates

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19. See, for example, job search sites on the Internet, Monster, <http://www.monster.com> (last visited Jan. 8, 2006), and Career Builder, <http://www.careerbuilder.com> (last visited Jan. 8, 2006). Both sites offer information about jobs free of charge and allow for online applications to various firms, but require applicants to fill out long forms that differ from each other for each and every workplace. Also, the complicated process of filling out the application forms required for receiving a visa to enter the United States is an example of raising transaction costs in order to screen out applicants who are not sure whether they indeed want to enter the United States. See U.S. Immigration Support, <http://www.usimmigrationsupport.org> (last visited Dec. 3, 2005).

20. An interesting example of screening out consumers who are not serious enough is the process students must go through in order to be admitted to top universities. Top U.S. law schools require that students invest a lot of effort in submitting their applications, including an essay requirement, detailed forms, and much more. It is true that some of these requirements are truly needed for evaluating the candidates as potential students. We suspect, however, that occasionally some of the requirements are not necessary, except for the purpose of assuring that the candidate "means business" and is less likely to withdraw his candidacy at a later stage. An alternative way to assure the candidate's seriousness would be to charge him a fine if he withdraws, or to require a deposit to ensure the admission, but sometimes this solution is impractical, especially when the harm from late withdrawal is relatively high. Moreover, it would be difficult and costly to distinguish cases of financial hardship, in which such fines may be inappropriate.

21. This information can be verified from the list of law reviews that appears at ExpressO's website. ExpressO is a service provided by Bepress for multiple submissions of papers to U.S. law reviews. See ExpressO, <http://law.bepress.com/expresso/> (last visited Dec. 3, 2005). To be sure, it could be that the appearance of ExpressO reduced the transaction costs involved in multiple submissions and also reduced the difference between the transaction costs born by foreign and domestic authors.

relatively high transaction costs are non-U.S. writers who bear higher mailing costs than their U.S. colleagues and other writers who bear mailing and other administrative costs themselves, costs which full-time professors usually shift to their universities. Notice that the multiple-submission system encourages concurrently submitting a paper to fifty or more law reviews, entailing very high administrative costs. Those who frequently submit to law reviews must be either writers who are very optimistic about the likelihood that their papers will be published, or writers who are able to shift all, or most, of the costs to others. The latter group consists mainly of U.S. (and some European and other) professors. If belonging to these two groups is a good proxy for the quality of the writer and the paper, the hard-copy requirement could be considered by some as appropriate. But is it a good proxy? Admittedly, there could be other explanations for the hard-copy requirement, such as the possibility that the law review is attempting to shift the costs of printing the documents to the author, due to the law review's budget constraints, coupled with the need to review hard, rather than electronic, copies. Nevertheless, even where the motivation for the practice is not one of screening out, the screening out effect mentioned above may remain intact.

Note that using transaction costs and standard-form contracts to screen out unwanted consumers could be sustainable even when the supplier faces intense competition from other suppliers. First, in some cases, such as the ethnic-discrimination examples, consumers the supplier wishes to retain do not bear considerable transaction costs, and therefore competing suppliers could not steal such consumers on account of such transaction costs. Second, even in cases in which consumers the supplier wishes to retain do bear some transaction costs, they usually enjoy the fact that other consumers are excluded. Accordingly, they may well prefer the supplier to competing suppliers who do not screen out unwanted consumers via transaction costs.

### B. *Price Discrimination*

Uniform goods and services are normally sold to consumers at uniform prices. A specific consumer's willingness to pay does not affect the price he pays. For obvious reasons, the supplier of uniform goods and services may find it beneficial to discriminate in prices in order to extract more surplus from consumers. However, price discrimination relating to uniform goods is sometimes prohibited by law. Even when price discrimination is permitted, the supplier could find it hard to implement. One main reason is that on many occasions a consumer's willingness to pay is unobservable to the supplier or the costs of verifying it are very high. Therefore, suppliers try to use proxies for consumers' willingness to pay. To illustrate, airlines charge consumers higher prices for short stays in the passenger's destination than for long stays. A possible explanation is that most short-journey travelers are businesspeople, while most long-journey travelers are people traveling on vacation, and on average, the former group, or their employers, are willing

to pay higher prices than the latter group.<sup>22</sup> Another common example is the use of coupons. Only consumers who collect coupons and bring them to the store will get a discount, while others will pay the regular price. On average, people who spend time collecting coupons are less willing to pay than people who do not do it, and only the former group will get lower prices.<sup>23</sup>

We claim here that a useful way to price discriminate is through boilerplate provisions and the imposition of transaction costs via standard-form contracts.

### 1. *Beneficial Terms*

*Example 4. Special Discount.* Supplier who sells TV sets offers, in a boilerplate provision, a special discount to consumers who fill out a certain form and mail it back to the supplier. Only consumers who read the boilerplate carefully and remember to fill out the form and mail it enjoy the special discount.

Many consumers would not pay too much attention to the special discount since they are willing to buy the product for its posted price. Such consumers do not explore the boilerplate provisions in order to find benefits such as the special discount. On the other hand, consumers who are not willing to pay the posted price are more likely to read the boilerplate provisions to look for benefits such as a special discount.

Example 4 represents cases where certain boilerplate provisions are beneficial only to consumers who are ready to incur the transaction costs the supplier imposed upon them, and typically those consumers are the ones less willing to pay. In Example 4, the transaction costs are the costs of reading, understanding, and remembering the special discount hidden in the boilerplate. The supplier hides the beneficial term in the boilerplate because he wants to benefit only consumers who would not have bought the goods at the posted price absent the beneficial term. If the beneficial terms had been more salient, many consumers, whose decision to enter the contract was not contingent upon receiving the benefits, would have also received them, and the supplier's overall profits would have been diminished.

There are many examples of cases in which consumers who are ready to incur the transaction costs receive an immediate price reduction. Thus, Barak, an international call carrier in Israel, offers special rates to consumers who call the carrier and sign up, while if they use the carrier without signing

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22. Andrew G. Celli, Jr. & Kenneth M. Dreifach, *Postcards from the Edge: Surveying the Digital Divide*, 20 CARDOZO ARTS & ENT. L.J. 53, 66 (2002); see also Marcel Kahan & Ehud Kamar, *Price Discrimination in the Market for Corporate Law*, 86 CORNELL L. REV. 1205, 1216 (2001).

23. See, e.g., Eitan Gerstner & James D. Hess, *A Theory of Channel Price Promotions*, 81 AM. ECON. REV. 872 (1991) (examining rebates as a possible tool for price discrimination); Hal R. Varian, *A Model of Sales*, 70 AM. ECON. REV. 651 (1980) (forming one of the pioneering economic models showing that suppliers can price discriminate between informed and uninformed buyers).

up they would pay rates approximately three times higher!<sup>24</sup> We suspect that the carrier tries to understate these benefits, hiding them from consumers who use the carrier's services anyway, without signing up. Consequently, there are many consumers who use the carrier's services for many years, not being aware of the very special rates they can get by making one short phone call.<sup>25</sup> These consumers are probably the ones who care less about their money or care more about their time (or are just careless?), and therefore are more willing to pay. Alternatively, they may be one-time consumers who find it prohibitively costly to invest in transaction costs when they have very little at stake.

An analogous example is hiding a best-price guarantee in the boilerplate.<sup>26</sup> In this example, the supplier undertakes in the boilerplate provision to match any competing offer given by another supplier. Another example is the case of selling goods with an option to return them and get a refund if

24. The carrier describes the discounted rates on its Internet site as its regular rates. Within a list of boilerplate conditions it mentions that these rates apply only to those who signed up. For details in Hebrew, see 013 Barak, Leḳoaḥ Prati—Ta'arifei Siḥot [Private Subscriber—Calling Rates], <http://www.013.net/heb/> (follow "Ta'arifon Siḥot" link) (last visited Jan. 4, 2006).

25. This example is based on personal experience. A similar example concerns using toll roads. We found out that a driver can receive a twenty percent discount for using a toll road in Israel if the driver, before using the road, calls a specific number in advance and signs up. When the driver calls and signs up, he has to fill out a form promising to pay via credit card and to agree that his license-plates will be videotaped. A discount of forty percent is available for drivers who call and agree to install an on-board unit on their cars. At first blush, such a procedure could lower the collection costs of the firm managing the toll road and explain the benefit. However, since the fines for delayed payments are extremely high, the firm does not have a strong economic incentive to encourage clients to sign up. For details in Hebrew, see Derech Eretz Highways Mgmt Corp. Ltd, Kvish 6 [Highway 6] (2002), <http://www.kvish6.co.il/> (follow "Hitstarfut Kemanui [Joining as a Member]" link). A similar example can be found in ECG, a U.S. long-distance call carrier, which offers a significant discount for interstate calls to clients who fill out a long enrollment form. See Enhanced Communication Group, ECG Secure Order, <https://myecgaccount.com/order/?sid=KZzk2u0xb2js5gAZTm1U8MG07hBPiHaz&page=qualify> (last visited Nov. 30, 2005).

26. Circuit City, an electronics retailer, makes the following guarantee in its "Terms of Use," found by following a link appearing in the fine print at the bottom of the site: "If you've seen a lower advertised price from a local store with the same item in stock, we want to know about it. Bring it to our attention, and we'll gladly beat their price by 10% of the difference. Even after your Circuit City purchase, if you see a lower advertised price (including our own sale prices) within 30 days, we'll refund 110% of the difference." Circuit City, Important Legal Information (Nov. 2005), <http://www.circuitcity.com/ccd/lookLearn.do?cat=-13317&edOid=105469&c=1>. Before the Good Guys, another electronics retailer, were subsumed by Circuit City, they also guaranteed prices: "If you find a lower verifiable delivered price (before tax) from bestbuy.com, circuitcity.com, or crutchfield.com, on an available product of the same brand and model, we'll gladly match that price . . . . Or, if within 30 days . . . of your purchase from goodguys.com, you find a lower verifiable delivered price from bestbuy.com, circuitcity.com, or crutchfield.com, on an available product of the same brand and model, we'll refund the difference." The Good Guys, Low Price Guarantee, at <http://web.archive.org/web/20041009231528/http://thegoodguys.com/help.asp> (archived Oct. 9, 2004). For a discussion of the competitive effects of low-price guarantees, see Aaron S. Edlin, *Do Guaranteed-Low-Price Policies Guarantee High Prices, and Can Antitrust Rise to the Challenge?*, 111 HARV. L. REV. 528 (1997). Edlin also points out that low-price guarantees enable price discrimination between customers who are aware of the guarantee and are willing to cite a competing price and other consumers. Our additional insight is that suppliers may want to "hide" their low-price guarantees in boilerplate language, rather than making them salient, so that only the particularly price-sensitive consumers would use the guarantees.

later the consumer changes his mind for any reason.<sup>27</sup> In recent years some stores have offered consumers, in their boilerplate terms, the option to return a good even after a few years and get a discounted refund.<sup>28</sup> Probably many consumers are not aware of these options, or do not care much about their existence. Others do care, and sometimes use the option to their benefit. Hiding such benefits from consumers who do not incur the transaction costs (of reading, understanding, and remembering the beneficial term) is a common strategy used by many suppliers, and results in price discrimination.<sup>29</sup> A similar practice is common in subscription sales. For example, Internet service providers often have a boilerplate provision granting customers signing up an option to cancel within a certain period of time and get their money back.<sup>30</sup> Many customers are not aware of this option, hidden in the boilerplate provision, and therefore do not use it. Probably those who are more hesitant about signing up would tend to incur the transaction costs and explore all the terms of the contract offered to them. They will be the ones taking advantage of the benefit.

The discussion thus far implies that at least three types of consumers will incur the transaction costs of reading, understanding, and remembering

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27. Even though such a practice is very common in the United States and many suppliers will refund the returned goods even without an explicit undertaking, in other countries, absent such a term, the price for the goods will not be refunded. An example of such a term can be found in the boilerplate of BigNet, an Israeli company that sells internet domains. BigNet offers a full refund within thirty days to unsatisfied customers. BigNet, *Havilot Ihsun* [Storage Packages] (1999), [http://bignet.co.il/articles/showArticle.asp?menu\\_id=60](http://bignet.co.il/articles/showArticle.asp?menu_id=60). A similar provision can be found in the terms of sale of an Israeli electronics retailer, E-Net, which promises a full refund for some of its products returned within fourteen days for any reason. See E-Net, *Ma'arekhet Yeshivah Me'or Amiti Dgam CHERRY* [Authentic Leather Seating Set, Cherry Model], <http://www.e-net.co.il/product.asp?productid=4966&CatCode=> (last visited Jan. 9, 2006). The same provision is offered by Sakal, another electronics retailer. Sakal, *Salon 'Or Niftah Me'or Napah Garox 3+2* [Garox 3+2 Napa Leather Partially Reclining Living Room Set], <http://www.sakal.co.il/jsp/pg/Product.jsp?comp=1&sec=2&prod=69535&saleNo=1009431> (last visited Jan. 9, 2006).

28. This observation is based on the personal experiences of one of the authors regarding several stores in Chicago. Unfortunately, he does not recall the identity of the store or the products purchased under these conditions, which proves our point!

29. Some analogous examples: Data Vision, an electronics retailer, suggests in its Terms of Sale that you, as a customer, can "contact your [datavis.com](http://www.datavis.com) account manager for our most current and competitive rates, options and shipping specials." Data Vision, *Terms and Conditions of Sale* (2001), <https://www.datavis.com/webapp/commerce/command/ExecMacro/Datavision/macros/statics/termsofsale.d2w/report>. Similarly, Novell suggests that customers interested in additional support visit the relevant site: "For more information on Novell's current support offerings, see Novell, <http://support.novell.com>." Novell, *Novell Software License Agreement*, <http://forge.novell.com/modules/xfcontent/file.php/nvds/DEPENDENCIES.html> (last visited Jan. 10, 2006). MPC, another electronics retailer, offers credit in its boilerplate for the return of replaced parts: "MPC will issue a credit to you for the return of parts being replaced from the new Product being upgraded or downgraded. Your request for a credit must be made (and a Returned Merchandise Authorization [RMA] number issued) within the time periods set forth . . ." MPC, *Terms and Conditions of Sale* (Aug. 30, 2004), [http://www.mpecorp.com/about/legal/terms\\_and\\_conditions\\_of\\_sale.html](http://www.mpecorp.com/about/legal/terms_and_conditions_of_sale.html).

30. See, for example, the boilerplate terms of sale of Speakeasy, which offers broadband Internet services: "Speakeasy offers a 25-day Trial Period on all ADSL services . . . If you feel that you must cancel within 25 calendar days of your Activation Date you may do so without being subject to a Disconnection Fee." Speakeasy, *Terms of Service* (Sept. 28, 2005), <http://www.speakeasy.net/tos/>.

the beneficial boilerplate terms. These are the consumers who care more about their money, care less about their time, or have more to gain from incurring the transaction costs. As noted, these are also the consumers who are typically induced to purchase the product on account of the beneficial boilerplate provision, while other consumers would buy the product regardless of the beneficial provision. Of course, this proxy of consumers' willingness to pay is an imperfect one.<sup>31</sup> In particular, some customers who do not incur the transaction costs would not be willing to pay the posted price absent the benefits. Conversely, some customers who incur the transaction costs would buy the product even absent the benefits but nevertheless incur them because they gain more than others from doing so or are more sophisticated and well-informed consumers.

Conferring benefits only upon those who know how to appreciate them is the mirror image of the familiar use of harsh boilerplate terms set by the supplier in order to extract surplus from consumers without them being aware of it. In both cases, the supplier incorporates a boilerplate term or terms, hoping that many consumers will not be able to estimate the negative or positive effect on their rights. In the beneficial-terms case, however, it seems that those who do not appreciate the beneficial terms and therefore do not receive them, cannot argue that their expectations were frustrated: they got exactly what they expected to get. This is in contrast to the familiar use of harsh boilerplate terms, where the main concern is that the consumer expected a different contract than the one she actually got. Later we discuss the legal implications of the similarities and differences between these two cases.<sup>32</sup>

## 2. Complexity

Example 5 illustrates how price discrimination through boilerplate provisions could also discriminate in favor of sophisticated consumers.

*Example 5. Cellular Packages.*<sup>33</sup> A cellular firm offers a menu of packages: each package differs from the others with regard to rate per minute, monthly fee, night rate, rates related to text messages (SMS rates), and so

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31. Indeed, as *infra* Section V.A reveals, the welfare effects of discrimination via boilerplate provisions hinge on the degree and direction of this proxy's imperfection.

32. A practice related to hiding benefits in the boilerplate is placing harsh terms in the boilerplate while allowing readers to avoid these terms. This way, the supplier could extract even more surplus from nonreaders, who believe they are buying a better product than they actually are. The supplier may hesitate to price discriminate in this manner, however, out of the fear of legal intervention.

33. In a similar vein, consider the various packages offered by credit card companies—low-interest credit cards, offering 0% introductory APR's; balance transfer cards, transferring a high-interest balance onto a low APR card; rewards credit cards, rewarding the customer for his purchases; cash-back credit cards, allowing the customer to earn cash back on purchases; prepaid debit cards, controlling spending with prepaid debit cards; credit cards for bad credit; and so forth. For a comparison between the different packages offered by various credit card firms, see CreditCards.com, <http://www.creditcards.com/> (last visited Jan. 8, 2006).

forth, in a way that it is difficult for a consumer to calculate which package is better.<sup>34</sup>

In this example, those who would incur the transaction costs and get the better deals are probably those who use their cellular phones more and therefore have more to gain from thoroughly exploring all of the available options. They could also be the more sophisticated consumers, who can easily understand the differences among the various options and choose the one most suitable to their needs. One could speculate that one of the reasons for offering so many packages with so many different features is price discrimination in favor of such customers. According to this theory, the cellular firm makes things complicated in order to offer better deals to high-volume or sophisticated users, who would often be more sensitive to the price they are required to pay. Other users, either because they are less sophisticated, or because they find the transaction costs prohibitively high since they have little at stake, might take the services at higher prices and sometimes get inferior services, without being aware of it.

### 3. Dependency

At times, the supplier could extract even more surplus from those who are more willing to pay by increasing transaction costs, through boilerplate language or otherwise, in order to create dependency of those consumers on the supplier. Dependency encourages such consumers to ask for the supplier's assistance, resulting in the purchase of more services and products.

Common examples are computer accessories and programs, which some consumers find hard to use without the supplier's assistance. At times, the need for assistance is a natural consequence of the complexity of the product. But it sometimes seems that suppliers make things more complex than necessary. For example, sometimes manuals for computer applications seem to be inaccessible to unsophisticated users.<sup>35</sup> The same phenomenon is apparent with respect to do-it-yourself products. While experienced consumers would be able to handle the accompanying instructions, which might be made artificially complex, and assemble the product, less experienced consumers would not be able to do so and would ask (and pay) for the supplier's assistance.<sup>36</sup>

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34. Consider, for example, the services offered by U.S. Cellular. U.S. Cellular, [http://www.uscc.com/usccellular/SilverStream/Pages/b\\_plan.html?zip=96006&mkt=606810&tm=0](http://www.uscc.com/usccellular/SilverStream/Pages/b_plan.html?zip=96006&mkt=606810&tm=0) (last visited Jan. 8, 2006). For a sophisticated comparison between various wireless phones and plans, see Get Connected, Wireless Phones and Plans, [http://www.getconnected.com/v\\_wireless/w\\_common\\_geography.asp?caller=v\\_wireless/index.asp%3Ftag%3Dp1%26](http://www.getconnected.com/v_wireless/w_common_geography.asp?caller=v_wireless/index.asp%3Ftag%3Dp1%26) (last visited Nov. 30, 2005).

35. The "Help" devices of Microsoft Office programs are too complicated for some users, who would prefer to pay for support or to learn about operation of the programs in special courses.

36. See, for example, a statement by IKEA that "IKEA products are generally easy to assemble and require no special tools. If you prefer, most IKEA stores can refer you to a reputable, reasonably priced assembly company that can come to your home to assemble and install our products." IKEA, IKEA FAQs, [http://www.ikea.com/ms/en\\_US/customer\\_service/faq/faq.html#0004](http://www.ikea.com/ms/en_US/customer_service/faq/faq.html#0004) (last visited Nov. 30, 2005). We are not arguing here that IKEA artificially creates such transaction

Accordingly, making the use of products artificially more complex results in price discrimination between sophisticated and unsophisticated, or experienced and inexperienced, consumers. Assuming that in these kinds of cases the unsophisticated (or inexperienced) consumers are less sensitive to the price they are required to pay, or less aware of the additional price they would have to pay for the supplier's assistance, the supplier could extract payments from these consumers that she would not have been able to extract but for the transaction costs she artificially created. At the same time, the supplier manages to retain sophisticated consumers with less willingness to pay.<sup>37</sup> As with the case in which benefits are hidden in boilerplate provisions, here the "benefit" enjoyed by those willing and able to incur the transaction costs involved in reading and understanding the instructions is the ability to save the additional payment to the supplier for additional services.

#### 4. *Price Discrimination and Competitive Pressures*

Could these forms of price discrimination through boilerplate terms survive competitive pressures? If nonreaders of boilerplate provisions also do not take the time to compare suppliers' competing offers, then no matter how many suppliers compete with each other, there is no point in setting competitive terms in the salient part of their contracts, because nonreaders of boilerplate provisions do not compare suppliers anyway.<sup>38</sup> This implies that if a large enough number of nonreaders of boilerplate provisions do not compare competing suppliers, hiding benefits in boilerplate provisions induces the supplier to raise the price he charges nonreaders. It further implies that this incentive would remain intact regardless of the number of the supplier's competitors. In such cases, even absent tacit or explicit collusion between suppliers, it is in each supplier's self interest to raise prices above competitive levels to nonreaders.

However, if a large enough number of nonreaders of boilerplate provisions do compare suppliers' offers, competitive pressure between suppliers could induce suppliers to try to steal nonreaders from one another via the salient terms in their contracts.<sup>39</sup> In such a case, discrimination via

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costs. We are merely referring to the possibility that it could benefit IKEA to do so under certain circumstances.

37. This could explain why suppliers sometimes use transaction costs and boilerplate language to create the dependency of some consumers on their additional services rather than explicitly tying the product and the additional services. With explicit tying, the supplier might lose sophisticated consumers, whereas such consumers could be retained when the supplier merely uses boilerplate language and transaction costs. Another reason could be that an explicit tie-in of the supplier's product and service is illegal.

38. In economic models of price matching, it has indeed been shown that the discrimination inherent in price matching—between consumers who cite rival prices and those who do not—survives in markets with many firms and may even be exacerbated the more firms there are in the market. See Edlin, *supra* note 26, at 543; I.P.L. Png & D. Hirshleifer, *Price Discrimination Through Offers to Match Price*, 60 J. Bus. 365, 372–74 (1987).

39. See Louis L. Wilde & Alan Schwartz, *Equilibrium Comparison Shopping*, 46 REV. ECON. STUD. 543 (1979) (showing that when a large enough percentage of consumers compare suppliers,

boilerplate provisions requires an oligopolistic setting, (that is, that the number of substantial suppliers competing with each other is small). Such a market is susceptible to tacit or explicit collusion between suppliers. As we show in Section II.C, hiding benefits in boilerplate provisions indeed helps facilitate such collusion over the terms offered to nonreaders.

Note also that the more artificial and cumbersome are the transaction costs readers need to incur, the more competing suppliers would tend to reduce the level of these transaction costs in order to steal readers from one another. After all, even a reader would prefer a supplier whose special discounts, for example, involve less transaction costs, to a supplier whose special discounts involve more transaction costs. If the market is competitive enough and a large enough number of readers exists, such competitive pressures could reduce the transaction costs imposed on all consumers to zero, so that discrimination between readers and nonreaders is dissipated. In this sense, even if many nonreaders do not compare suppliers, discrimination via boilerplate language requires either collusion between suppliers or at least that suppliers possess some degree of market power. Such market power could stem, for example, from product differentiation<sup>40</sup> or from capacity constraints.<sup>41</sup>

### 5. "Drawing" Beneficial Terms

Thus far, we have discussed price discrimination based on the different effects transaction costs have on different consumers. The virtue to the supplier of this mode of discrimination is that it induces consumers to reveal themselves as readers or nonreaders of boilerplate provisions. The supplier uses this revelation to deduce whether a consumer has low or high willingness to pay for the product. At times, however, the supplier could do better by identifying consumers with low willingness to pay in other ways (for example, according to their behavior in the supplier's shop), and "drawing" the beneficial boilerplate terms in their favor.<sup>42</sup>

To illustrate the "drawing" mode of price discrimination, we use Example 4 (special discount). In this example, a TV-set seller incorporates a

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suppliers are induced to charge competitive prices). Wilde and Schwartz assume in their model that each supplier charges all consumers the same price. In contrast, we explore cases in which the supplier can charge readers of boilerplate language lower prices than he charges nonreaders. This is why when most nonreaders also do not compare suppliers, suppliers are induced to raise prices to nonreaders, notwithstanding competitive pressures.

40. With product differentiation, readers that prefer the supplier's brand to competing brands will be willing to incur some transaction costs and stick with the supplier's brand. *See generally* JEAN TIROLE, *THE THEORY OF INDUSTRIAL ORGANIZATION* 280 (1988).

41. In the case of capacity constraints (that is, constraints on the quantity the supplier is able to supply, such as limited plant size, limited distribution channels, and so forth), suppliers cannot reduce transaction costs imposed upon readers to zero, since then they would not have the capacity to serve all readers that would flow to them. This too grants suppliers some degree of market power. *See generally id.* at 215–16.

42. There also could be particular consumers the supplier wants to benefit for other reasons. For example, the supplier might fear that some consumers who have not received the benefits would find out about them later and would retaliate by not transacting with the supplier anymore.

boilerplate term providing that a consumer who fills out a form and mails it to the supplier receives a special discount. Instead of hiding this term from all consumers, hoping the “right” consumers will read and understand it, the supplier could reveal the provision only to hesitant consumers.

The same tactic could be used by the supplier in Example 5 (the cellular packages), and also in cases where the supplier intends to offer beneficial terms to new consumers or to old consumers who consider switching to another supplier, but not to old consumers who do not consider such a switch. Instead of explicitly limiting the applicability of the beneficial terms to new consumers or those who consider a switch to a new supplier, thereby frustrating other faithful consumers, the supplier could draw the beneficial terms from the boilerplate any time she believes it is beneficial for her to do so. Old consumers who have not received the benefit would sometimes be able to receive it later after discovering it in the boilerplate, and, in any case, they would be less frustrated, because they would believe it was their fault (not noticing the beneficial boilerplate term) and not the supplier’s fault (having offered the beneficial boilerplate term to all consumers). The case of the international-call carriers we discussed above<sup>43</sup> could serve as a possible illustration also for such cases.

The preceding discussion demonstrates the advantage to the supplier in incorporating a beneficial boilerplate term and drawing upon it when necessary, instead of simply offering it to the appropriate consumers without incorporating it as a boilerplate term. This way the supplier could avoid reputational sanctions or retaliation by frustrated consumers who have not enjoyed the benefits offered to other consumers.

### *C. Hiding Benefits Granted to Selected Consumers*

In Section I.B, we discussed the role of boilerplate language and the transaction costs generated through it in segmenting consumers for the purpose of price discrimination. Here, we deal with a related issue: sometimes there are privileged consumers who are entitled to benefits beyond what most consumers expect. These benefits could be granted outside, and independently of, boilerplate language. Still, the supplier would often like to understate these benefits in order to avoid frustrating the consumers who do not receive them. Moreover, sometimes consumers who are aware of the benefits granted to others but not to them rightly suspect that they may be subsidizing those benefits by paying more, or receiving less, than the benefited consumers. Example 6 illustrates this point.

*Example 6. Frequent-Flyer Miles.* An airline grants privileges to passengers for high mileage (“frequent flyers”). Many passengers are not and will not be entitled to the privileges, since they do not fly frequently enough. In all of the airline’s forms, which establish the legal relationship between the airline and the passengers, the privileges for frequent

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43. See *supra* note 24 and accompanying text.

flyers are understated. However, the airline directly mails frequent flyers all the relevant details concerning the privileges they are entitled to.

In Example 6, the airline might hint in the forms distributed to all consumers about the existence of a “frequent flyer” status, urging those who are interested in more details to call the company for further information.<sup>44</sup>

#### D. Collecting Information about Consumers’ Preferences

As noted, suppliers are often unaware of consumers’ willingness to pay for the product, so they use boilerplate language and transaction costs in order to induce each consumer to reveal her willingness to pay. Suppliers would often like consumers to reveal not only their willingness to pay, but also their preferences. This information helps suppliers market their products and services to new consumers, but is also useful in planning the performance of the contract or future marketing efforts vis-à-vis their existing consumers. Occasionally, boilerplate language and the imposition of transaction costs could serve as useful and reliable tools for extracting this information from consumers. In certain cases, the information collected could be sold to other suppliers, who could use it for their own businesses. As we will immediately see through Example 7, transaction costs play once again an important role in achieving the supplier’s goals.

*Example 7. Learning the Attractiveness of Services.* A cellular phone company is interested in learning the attractiveness to consumers of various services. To achieve this goal, the company makes these services available to consumers, conditioned upon some transaction costs they must incur in order to get these services. For example, the company could ask consumers to order services through a process that requires them to read and learn instructions placed in boilerplate language, to fill out long and time-consuming forms, and so forth.<sup>45</sup>

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44. Northwest Airlines, for example, grants its frequent fliers significant benefits and discounts, but the client has to fill out a special form in order to enroll as a frequent flier, and the enrollment information is not prominent on Northwest’s Internet site. Nw. Airlines, Enroll in WorldPerks—U.S. Residents, [https://www.nwa.com/cgi-bin/wp\\_enroll.pro?Country=US](https://www.nwa.com/cgi-bin/wp_enroll.pro?Country=US) (last visited Dec. 6, 2005). A similar practice is adopted by American Airlines. Am. Airlines, Advantage Terms & Conditions, <https://www.aa.com/content/AAAdvantage/programDetails/termsAndConditions/termsAndConditions.jhtml> (last visited Dec. 6, 2005). Anecdotal evidence suggests that frequent fliers of these airlines receive more salient information via direct mail.

Similarly, an Israeli virtual “mall,” Nana Shops, declares in its boilerplate Terms of Sale that the customers of the Internet provider Netvision are entitled to special privileges from time to time. Terms of Sale, art. 15, <http://www.nanashops.co.il/disclaimer.php> (last visited Jan. 31, 2006). Analogous examples are the exclusive “Platinum” and “Gold” clubs offered by different credit card companies to their VIP customers. For instance, see the long forms required to apply for a Blue Cash card—an exclusive American Express credit card. American Express, Get Blue, <https://www66.americanexpress.com/cards/Applyfservlet?csi=38/7011/b/57/2329415368/232032305522/0/n&PID=1&EAID=EhraRx8K%2FBFE-gRzAzq6fakkj%2AuC1wExC4g&CRTV=CCGBLU00001102&PSKU=CCGBLU&afflSID=EhraRx8K%2FBFE> (last visited Jan. 9, 2006).

45. See, for example, the membership forms of DriverGuide, a web site that enables members to download drivers for various computer programs. The service is free of charge, but in order to download a driver, the user must become a member. As part of the registration process, the web site offers different computer products, some of which are free of charge. In order to proceed with

Had the cellular phone company not conditioned the availability of the various services upon incurring the transaction costs, most consumers would order these services and the cellular phone company would know very little about their preferences. Arguably, the company could collect payment for each service, even a small one, thereby achieving the same goal at a lower cost (or even with a gain) to itself. But even if this strategy could be useful on some occasions, the strategy of imposing transaction costs described in Example 7 could be more useful on other occasions. First, in some cases the company would find it too costly to monitor each and every use of the service and then calculate the appropriate payment for such use. But more importantly, the main advantage of the imposition of transaction costs over charging a payment is that many consumers would be willing to bear the transaction costs but not to pay the cellular phone company for additional services it offers. This is so not only because many people care more about their money than they care about their time,<sup>46</sup> but also because consumers might not trust a company that asks to be paid for such services, suspecting that the company is trying to make additional profits at their expense. Learning about consumers' preferences for different services via transaction costs rather than via payment for services can thus be seen as an aggressive competitive move on the part of the cellular phone company: the additional services are granted free of charge, while the transaction costs are used to ensure that only consumers especially interested in a service would use it.

A cheap and reliable way to learn about consumer preferences is through the Internet. In cases where consumers are required to surf from one link to another to search for the goods or the services they want to buy, thereby incurring transaction costs, it is relatively easy to track a consumer's moves from one page to another and learn about her preferences even if eventually she buys nothing.<sup>47</sup>

## II. PREVENTION OF COMPETITION AND CARTEL STABILIZATION

### A. Introduction: When Is Tacit Collusion Sustainable?

In many industries, particularly oligopolies (that is, industries with only a few substantial firms), tacit or explicit collusion becomes possible.<sup>48</sup> While explicit collusion can often be deterred by antitrust law, it is well known that firms can sustain a cartel-like price even absent explicit communication

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the registration process, the user must click "yes" or "no" near the product icon. In addition, the user must answer which newsletters containing special offers and discounts she wishes to receive. The user specifies her fields of interest by clicking on the relevant fields and by deciding which product she wishes to receive free of charge at the end of the process. The possibility of skipping the process of choosing the newsletters and the free item is provided in fine print, not reasonably observable to many users. See DriverGuide, *supra* note 13.

46. See Duxbury et al., *supra* note 15.

47. Hillman & Rachlinski, *supra* note 3, at 471–72 (arguing that businesses that use the Internet collect a tremendous amount of data on their potential consumers—including their willingness to read and shop for terms—and may use it, among other things, for price discrimination).

48. See, e.g., TIROLE, *supra* note 40, at 239–70.

between them (hereinafter, tacit collusion).<sup>49</sup> This is because, given that all firms charge a collusive price, each firm faces a trade-off between the short-term gain that it could make by deviating from the collusive price and stealing market share from its rivals and the long-term loss that would evolve from the price war that would be triggered.<sup>50</sup> If all firms are such that their long-term loss from a price war outweighs their short-term gain from cutting prices, tacit collusion becomes sustainable, to the detriment of consumers. If, on the other hand, one or more of the firms finds price cutting so profitable that it outweighs the long-term loss from a price war, tacit collusion breaks down, and competitive pricing evolves. In fact, the firm most eager to cut prices is the only firm whose incentives matter. If it prefers to cut prices, collusion breaks down, and if it prefers not to cut prices, collusion is sustainable.<sup>51</sup> Antitrust agencies call such firms “maverick firms.”<sup>52</sup>

Note that the industry maverick’s eagerness to cut prices may be more of a vice than a virtue. The maverick’s gains from price cutting can be produced only if a collusive price is in place. However, since the maverick’s rivals often know of its eagerness to cut prices, they may well refrain from charging a collusive price to begin with, if they fear that the maverick would then undercut this price and steal their customers. In such cases, collusion is not sustainable, and all firms, including the maverick, usually earn lower profits than they could have earned had collusion been sustainable.

Accordingly, the maverick could raise its profits by making collusion sustainable. In order to do so, it needs to commit to becoming less eager to cut prices.

In what follows, we shall show how boilerplate provisions in contracts or the imposition of transaction costs could be used to facilitate explicit or tacit collusion.

### B. Making It Difficult to Compare among Rivals

Firms in various industries often tend to make the terms of sale included in their boilerplate provisions complicated and difficult for consumers to understand or assess. We claim that such complexity can harm competition. Let us illustrate by using the following example:

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49. Although earlier cases may have been understood as considering mere parallel pricing as an agreement violating section 1 of the Sherman Act, *see, e.g.*, *Am. Tobacco Co. v. United States*, 328 U.S. 781, 810 (1946); *Interstate Circuit, Inc. v. United States*, 306 U.S. 208, 226 (1939), it became clear in later cases that absent some evidence of communication or coordination, the agreement requirement of this section is not met. *See, e.g.*, *Brooke Group Ltd. v. Brown & Williamson Tobacco Corp.*, 509 U.S. 209 (1993); *Theatre Enters. v. Paramount Film Distrib. Corp.*, 346 U.S. 537, 541 (1954); *United States v. Gen. Motors Corp.*, 1974-2 Trade Cas. (CCH) ¶ 75,253 (E.D. Mich. 1974).

50. *See supra* note 48.

51. *See* David Gilo, *The Anticompetitive Effect of Passive Investment*, 99 MICH. L. REV. 1, 17–18 (2000); David Gilo, Yossi Moshe & Yossi Spiegel, *Partial Cross Ownership and Tacit Collusion*, 37 RAND J. ECON. (forthcoming 2006) (manuscript at 13, on file with author).

52. *See* 1992 Horizontal Merger Guidelines, 57 FED. REG. 41,553, 41,559–60 (Sept. 10, 1992).

*Example 8. Complex Cellular Contracts.* Two cellular firms, firm A and firm B, compete and both offer a menu of packages: each package differs from the others with regard to factors such as rate per minute, monthly fee, night rate, SMS rates, and so forth, in a way that makes it difficult for a consumer to calculate which supplier offers a better deal.

In the following subsections, we shall discuss three anticompetitive effects that could stem from such complexity of contracts. The first is the facilitation of collusion, the second is the raising of prices even absent collusion, and the third is entry deterrence.

### 1. *Facilitation of Collusion*

The complexity of the contracts in Example 8 could contribute to the stability of noncompetitive terms. If both cellular firms offer noncompetitive terms, the profits one of them could make by offering more competitive terms are small, since many consumers would find it difficult to assess whether the complex terms offered by their current cellular provider are better than the competing offer. For example, suppose firm A tries to offer a benefit with regard to one or some of its packages. How can a customer of firm B know if firm A is offering him a better deal? In order to do so, tedious calculations are needed. Even if she manages to learn which of A's packages is best for her, she needs to assess all of the parameters in B's packages and compare them with the way A's offer deals with these issues. The customer does not want to make a hasty decision since she typically has to incur costs in switching suppliers.

Accordingly, many consumers would hesitate to move from firm B to firm A. This makes a price cut or other competitive benefit offered by A much less profitable. Not only is A possibly triggering a costly price war in the long run, but the gain it could make by stealing customers in the short run may be very small. To be sure, A could try to advertise and explain in detail how *all* of its possible packages are better than all of B's packages, but such an offer would be costly. Note that the most profitable way to deviate from collusive terms is to offer only a slight benefit compared to the rival with a hope of stealing as many of the rival's customers as possible. But with complex contracts, a slight and subtle benefit cannot steal many customers, because they fail to assess it. In order to offer consumers a simple deal that is bluntly better than each and every one of B's different and various packages, A would need to offer an extreme benefit. But while offering a large benefit compared to B could steal substantial market share from B, A's profits per unit made during the price cut would be much lower than those A makes during collusion.<sup>53</sup> The less profitable such a defection from collusion becomes, the less likely it is to overcome the expected long-term

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53. An alternative strategy for A could be to offer a simple contract with what A knows to be a subtle improvement compared to B. However, many customers would not switch to A merely because his contract is simple, and would require a value-based comparison before switching. As noted, such a comparison is prohibitively costly when B's contract is complex.

losses from the price war that would follow. B would be similarly less inclined to cut prices. The same goes for A and B's incentives to compete over new customers. If a new customer finds it impossible to compare the two offers, there is no need for them to compete over her.

Note that unlike consumers, firms A and B would not find it hard to assess whether their rival has deviated from a collusive equilibrium. After all, A and B are sophisticated and have a lot at stake. Accordingly, it cannot be said that contract complexity could make A and B more *eager* to cut prices, because their rival would not know about the price cut. As long as deviation from a collusive scheme is made vis-à-vis end consumers, it is readily detectable by a rival firm, regardless of contract complexity.<sup>54</sup>

Such complex contracts support an equilibrium in which competition is less fierce, and profits, accordingly, higher. Note that this effect of contract complexity exists whether or not suppliers mean it to facilitate collusion. It could be that contracts are complex for other reasons. Still, the effect is the same: improved sustainability of collusive terms.<sup>55</sup>

We found several examples of oligopolistic markets in which competing suppliers offer extremely complex contracts. Cellcom, for example, the leading Israeli cellular provider, with a thirty-four percent market share,<sup>56</sup> has given consumers an option to elect one of seven different packages. Consumers may switch between these packages at will at no extra cost. The packages differ from each other (some only slightly) with regard to various parameters, including the monthly fixed fee; rate per minute; number of people that the consumer may call at a cheaper rate per minute; times of day or days in which the rate is lower; number of minutes per month above which the rate per minute is lower; the rates for additional services such as SMS messages, downloads, ringtones, or Internet; the rates for calls to other networks or fixed line phones; and so forth. Each of the packages features, on average, nine parameters needed in order to calculate the attractiveness of the package. Similarly complex are the packages sold by Orange, Cellcom's rival of almost equal size, with a thirty-two percent market share. Orange has seventeen different packages that again, on average, require the consumer to assess nine different parameters in order to calculate the value of the deal he will obtain. Two of the packages are displayed in a forty-six column, fifty-three row table.

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54. It could be claimed that the collusive scheme itself is more difficult for A and B to coordinate when contracts are complex. However, in an oligopolistic setting, once, at a certain stage, A and B's packages are supracompetitive (say because one of them introduced such packages and the other tacitly followed by offering such packages), they would be less likely to deviate and offer competitive packages.

55. That said, if indeed the complexity of the contracts facilitates collusion, suppliers should probably be presumed to intend, or at least take account of, the reasonable effects of their behavior.

56. The data was taken from YNET, an electronic newspaper. Posting of Omri Levi to <http://www.ynet.co.il/home/1,7340,L-876-18051-12908911,00.html> (July 28, 2005, 21:28 Israeli time).

Similar complexities exist in other markets, such as some long-distance and cellular phone markets in the United States.<sup>57</sup>

## 2. Raising Prices Even Absent Collusion

Interestingly, complexity of contracts also typically raises the prices that would prevail absent collusion. As is well known, in markets with only a few firms, even absent ongoing collusion, prices will often exceed marginal costs. Common reasons for this are product differentiation (that is, consumers do not see the competing products as perfect substitutes)<sup>58</sup> and capacity constraints (that is, firms are not able to lower prices all the way down to marginal costs, due to their capacity constraints).<sup>59</sup>

Consumers' difficulties in fully understanding the value they get from a supplier, and their consequent difficulties in comparing suppliers, can enable suppliers in such industries, even absent collusion, to raise prices even further above marginal costs. Suppose, for example, that in the market discussed in Example 8, the equilibrium price when contracts are easy to understand is \$10 per unit. That is, none of the cellular firms wishes to raise its price above \$10, because they fear that then too many consumers would prefer the competing supplier, and the supplier attempting the price raise would lose too many customers to justify the elevated profit per unit.

Now suppose, however, that the cellular firms change their contracts so that it becomes more difficult for consumers to compare between them. It is quite intuitive that this would give the cellular firms the power to profitably raise prices, say, to \$11 per unit. If firm A, for example, charges \$11 although firm B charges only \$10, many of the consumers would find it hard to verify that the deal they receive from A, weighed according to all of its other complex parameters, is worse than the deal they get from B. Even though B's price per unit is somewhat lower, many consumers would not switch to it. This could make the price hike by A profitable. The same goes for firm B, which may also find it profitable to charge \$11 per unit.<sup>60</sup> Indeed, various economic models find that elevated search costs, which consumers

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57. See CONSUMER & GOV'TAL AFFAIRS BUREAU, FED. COMMC'NS COMM'N, CELL PHONES: HELPING CONSUMERS MAKE SENSE OF THE MARKET (2002), available at [http://www.fcc.gov/cgb/cell\\_phones.html](http://www.fcc.gov/cgb/cell_phones.html) (noting that choosing a cellular phone plan can be overwhelming, and reviewing factors important to consumers in selecting a plan). The complexity of the cellular phone market is prominent in the various sites comparing the cellular package offered by different cellular providers. See, e.g., Consumer Search, Wireless Plans Reviews, <http://www.consumersearch.com/www/electronics/wireless-plans-reviews/> (last visited Nov. 8, 2006); Phone Dog, Free Cell Phones & Great Specials, <http://www.phonedog.com/cell-phone-shopping/default.aspx> (last visited Nov. 8, 2006); Wireless Guide, Comparison Shopping for Cell Phones, <http://www.wirelessguide.org/phone/comparison-shopping.htm> (last visited Nov. 8, 2006). Such sites could be viewed as a market reaction to deal, although imperfectly, with the extreme complexity of firms' contracts.

58. See TIROLE, *supra* note 40, at 294–95.

59. See *id.* at 209–38; see also *supra* note 41.

60. This also applies to nonprice terms of the contract. When contracts are complex, suppliers are less hesitant to offer poorer nonprice terms, as they do not expect to lose much market share when they do so.

need to bear in order to compare between competing suppliers, have the effect of raising prices in oligopolies, even absent ongoing collusion.<sup>61</sup>

Interestingly, the effect of raising prices absent collusion may serve to help collusion break down and thus counteracts the effect discussed in Section II.B.1, above. This is because if complexity of contracts raises prices and profits absent collusion, and if firms charge such prices when collusion breaks down, the long-term losses they suffer from a price war would be smaller, and they would be less hesitant to cut prices. According to this reasoning, complexity of contracts may have an ambiguous effect on the prospects of collusion: on the one hand, as identified in Section II.B.1, it makes collusion more sustainable by lowering the short-term gains from price cutting. On the other hand, as identified in the current Section, it makes collusion less sustainable, by lowering the long-term loss from the price war that evolves when collusion breaks down. Two caveats are in place, however. First, it is quite unlikely that firms would make their contracts artificially complex if this causes collusion to break down. Accordingly, if we observe artificially complex contracts, it is plausible to assume that either collusion is sustainable or that it would be unsustainable even absent the complexity. Second, as some economic studies show, firms may be able to adopt strategies in which price wars are more painful than a mere reversion to the prices that would have evolved in equilibrium absent collusion.<sup>62</sup> For example, during a price war, contracts could become simple and profits accordingly lower. If such strategies are adopted, only the collusion facilitating effect of complexity remains.

### 3. *Entry Deterrence*

Complexity of contracts can also serve as a barrier to entry of new firms into the market. Suppose that a new entrant, firm C, wishes to enter the market portrayed in Example 8. Firm C would find it hard to steal customers away from the incumbent cellular firms, because their customers would find it hard to verify that firm C is indeed offering them a better deal. Firm C could make an effort to explain its advantages to consumers, but this would be costly and possibly ineffective, and would, again, reduce the expected profits from entry, and make it less likely.<sup>63</sup>

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61. See Simon P. Anderson & Régis Renault, *Pricing, Product Diversity, and Search Costs: A Bertrand-Chamberlin-Diamond Model*, 30 RAND J. ECON. 719 (1999) (showing that prices in oligopoly rise when search costs rise). These results have also been supported empirically. See Christopher R. Knittel, *Interstate Long Distance Rates: Search Costs, Switching Costs, and Market Power*, 12 REV. INDUS. ORG. 519 (1997) (showing that search costs and switching costs have enabled long-distance carriers in the United States to raise prices after the dissolution of AT&T).

62. See Dilip Abreu, *Extremal Equilibria of Oligopolistic Supergames*, 39 J. ECON. THEORY 191 (1986).

63. Note that not all firms need to offer complex contracts in order for the anticompetitive effects of complexity to exist. As long as complexity is abundant enough, it would be useless for a rival offering a simple contract to try to steal customers from suppliers who offer complex contracts.

### C. How Can Beneficial Boilerplate Terms Facilitate Collusion?

#### 1. Collusion over Harsh Boilerplate Terms versus Collusion with Beneficial Boilerplate Terms

It is understandable that a monopolistic supplier may want to use a value-reducing boilerplate provision, which many consumers do not read, hoping that consumers who do not read the provision would be willing to buy the supplier's product for a relatively high price, while they would not have bought it for that price had they read the harsh provision. How can such value-reducing terms be sustained, however, in markets in which more than one significant supplier compete with each other? In such markets, if one supplier attempts to include value-reducing boilerplate terms in his contracts, the competing supplier may be tempted to highlight this fact in his advertisements, offer consumers a better deal, and steal them away from the first supplier.<sup>64</sup> As noted, however, in oligopolistic markets, tacit collusion over value-reducing terms (or supra-competitive prices) could be sustainable. Let us illustrate using the following example:

*Example 9. Collusion over Harsh Terms.* Firms Alpha and Beta compete with each other in selling televisions. They tacitly or explicitly collude over placing a boilerplate term in their contracts according to which once a television is bought and used, it is nonrefundable.

The question whether collusion between Alpha and Beta is sustainable in the current context hinges on the comparison between the parties' short-term gain during a deviation from collusion and their long-term loss from the price war that would evolve. The short-term gain would involve the profits either of them (say, Alpha) could make by highlighting its rival's harsh boilerplate term, offering refunds for returned televisions, and stealing business. The price war that would be triggered would involve Beta fighting back, canceling the value-reducing boilerplate term, and offering refunds or even more overreaching benefits or price cuts. This would cause the terms of the suppliers' contracts to be competitive, and in the long run, they would forego the collusive profits they could have made had collusion not broken down. If, for both Alpha and Beta, the long-term loss from a price war outweighs the short-term profit from price cutting, collusion over the harsh boilerplate term would be sustainable. If, on the other hand, for either Alpha or Beta, the short-term profit from price cutting outweighs the long-term loss from a price war, collusion would break down.

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64. Unlike us, Korobkin implicitly assumes that the saliency of the terms is given exogenously. Korobkin, *Bounded Rationality*, *supra* note 5, at 1206. This drives his conclusion that "[w]hile sellers have an economic incentive to provide the efficient level of quality for the attributes buyers consider ("salient" attributes), they have an incentive to make attributes buyers do not consider ("non-salient" attributes) favorable to themselves." *Id.* Our point in the text, however, is that the saliency of terms is, for the most part, endogenous: a supplier could snatch business from his rival by highlighting the rival's harsh nonsalient terms.

Our next claim, however, is that such tacit collusion over value-reducing boilerplate terms could be extremely fragile and would often tend to break down. When such collusion breaks down, another form of collusion would often be more robust. Under this other form of collusion, suppliers could offer collusive terms to everyone but the readers of boilerplate provisions, who would be offered more competitive and attractive terms. This is illustrated in Example 10:

*Example 10. Collusion with Beneficial Boilerplate Provisions.* Firms Alpha and Beta compete with each other in the sale of televisions. They tacitly or explicitly collude on the terms offered to all consumers, but both offer, in a boilerplate provision, a special competitive discount to consumers who fill out a certain form and mail it to the supplier. Only consumers who read the boilerplate carefully, remember to fill out the form, and mail it enjoy the special discount.

In what follows, we will explain why this other form of collusion would be more sustainable, and, at times, also a more profitable way to collude, than that of Example 9 above. As Section II.A reveals, collusion is more sustainable the less profitable are the deviations from collusion and the more profitable is collusion itself (that is, the more harmful are price-wars in which collusive profits are forgone). With collusion over value-reducing boilerplate terms, as in Example 9, the short-term gain from deviating from collusion is the business a supplier is able to steal by highlighting his rival's value-reducing boilerplate term and offering a better deal. He can then steal two kinds of consumers: readers of boilerplate terms, who are aware of the nonrefund clause, and nonreaders of the boilerplate terms, who find out about the term only when the deviating supplier highlights it. Note that these short-term profits from deviation are potentially large.<sup>65</sup> Not only can deviation steal both readers and nonreaders of the boilerplate terms, but consumers might develop antagonism about a supplier that until then tried to abuse them via value-reducing boilerplate terms.

In addition, one cannot ignore the harsh legal treatment toward value-reducing boilerplate terms. To the extent that such terms can be invalidated by law, collusion over them again becomes fragile. It is enough if one of the suppliers' value reducing boilerplate terms are invalidated by a court for such collusion to break down. The supplier whose terms were invalidated would potentially steal market share from rival suppliers; there would be competitive pressure on these rival suppliers to remove their value-reducing terms as well, even if they were not attacked in court.

Now consider Example 10, in which suppliers offer collusive terms to everyone but the readers of boilerplate provisions, who pay the competitive price thanks to the special discounts. Here, deviating from collusion (that is, by offering discounts not only to readers of the boilerplate provision, but to all customers), becomes much less profitable for several reasons. First, such

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65. Of course, "large" is a relative term. We shall claim below that the collusion portrayed in Example 10 is more stable than the collusion portrayed in Example 9, particularly because the profits from deviation from the collusion in Example 10 are smaller.

deviation has the potential of stealing only nonreaders of the boilerplate provision, since readers of the boilerplate provision already enjoy the special discounts, and thus have no reason to prefer the deviating supplier.<sup>66</sup> Second, even the nonreaders of the boilerplate provision would not necessarily switch to the deviating supplier. Their original supplier could retain them by pointing out to them that the special discount was in their contract (in a boilerplate) all along. This would also minimize consumer antagonism. Consumers would not feel they have been deceived but merely that they have not done such a good job at reading their contract. Third, the chance that deviation is motivated by an attempt to exclude competitors is smaller. At times, suppliers deviate from collusion because they hope to exclude their rivals completely by setting terms their rivals cannot match, say, due to cost constraints. Supplier Beta, in Example 9 above (in which there are collusive boilerplate terms), could try to offer salient discounts, or analogous benefits, in order to try to drive Alpha out of business. However, in situations resembling Example 10, in which Alpha is already offering such beneficial terms in its boilerplate provisions, Beta receives a credible signal as to how efficient Alpha is and how capable it is of offering benefits to consumers. If Alpha has persisted with the beneficial boilerplate provision for a considerable period, Beta understands that Alpha is capable of granting such benefits to all consumers if competition becomes fierce. This signal could deter Beta from trying to exclude Alpha. When exclusion is not an option, friendly accommodation of Alpha and collusion with it can become the most profitable strategy.<sup>67</sup> Accordingly, deviation from collusion over harsh terms is more profitable than deviation from collusion with competitive benefits hidden in the boilerplate.<sup>68</sup>

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66. In this sense, hiding benefits in boilerplate language is a stronger facilitator of collusion than price-matching policies, in which the supplier promises to match a rival's price cut. With price matching, a price matcher's rival can still make considerable profits from deviating from collusion, due to consumers' hassle in going to the rival and then back to the price matcher in order to invoke the price match. See Morten Hviid & Greg Shaffer, *Hassle Costs: The Achilles' Heel of Price-Matching Guarantees*, 8 J. ECON. & MGMT. STRATEGY 489 (1999). In contrast, with hidden benefits in boilerplate language, the rival cannot steal readers, since they are already enjoying the competitive benefits.

67. See generally TIROLE, *supra* note 40, at 305–42 (discussing the above interaction between exclusion and accommodation of rivals). Note that if Beta is so efficient that he can profitably undercut even Alpha's beneficiary terms, exclusion would have occurred with or without the beneficial boilerplate terms. Accordingly, it cannot be said that the beneficial boilerplate terms can prevent exclusion of Alpha. All they do is prevent unsuccessful attempts by Beta to exclude Alpha. Arguably, Alpha could try to pretend to be more efficient than it really is by having below-cost boilerplate terms. Alpha could cross-subsidize these below-cost terms via the collusive profits it makes at the expense of nonreaders of the boilerplate term. This would make Alpha's signal to Beta less credible. Still, Beta should place a positive probability on the risk that Alpha is not selling to boilerplate readers below cost. After all, such cross-subsidization forgoes a substantial portion of Alpha's collusive profits and is therefore costly to Alpha. Accordingly, it is still the case that Beta would be less likely to try and exclude Alpha.

68. To be sure, it also should be examined whether collusion over harsh terms is more *profitable* than collusion with beneficial competitive terms, in which case the former may still be more sustainable than the latter. On the one hand, with the former type of collusion, the supplier loses many readers, who are retained with the latter type of collusion. On the other hand, ignoring the risk

## 2. *Collusion with Beneficial Boilerplate Terms versus Collusion without Such Terms*

Competitive beneficial boilerplate terms as in Example 10 make price cutting less profitable not only compared to the collusion portrayed in Example 9 (over harsh boilerplate terms), but also compared to a situation where Alpha and Beta collude on a uniform price without any boilerplate provisions (either harsh or beneficial). In the latter case, if Alpha and Beta try to collude on the terms of their contracts, their short-term profits from deviating from collusion become larger: the deviating supplier can steal all types of consumers—readers and nonreaders of boilerplate provisions alike. On the other hand, when they place competitive discounts in their boilerplate terms, as in Example 10, a deviating supplier can steal only nonreaders. Even nonreaders could remain with their current supplier (with no hard feelings toward their supplier) if their current supplier immediately makes it apparent to them that they could have enjoyed the benefits hidden in their contract all along. Furthermore, as explained above, to the extent a supplier wishes to deviate from collusion in order to exclude its rival, it is less likely to do so when suppliers can hide benefits in boilerplate provisions.

Finally, the collusive profits when hiding benefits in boilerplate provisions may well be larger, due to the fact that without benefits hidden in the boilerplate, many readers end up not purchasing the product, whereas they would have purchased it with the hidden benefits. It is true that readers who do purchase the product when Alpha and Beta collude over a uniform price pay more than they would have paid had they enjoyed the competitive benefits hidden in the boilerplate. Suppliers, however, always have the option of not hiding benefits in their boilerplate. Hence, if they do so in a particular case, it could imply that the former effect outweighs the latter effect and that it is more profitable to suppliers to hide benefits in the boilerplate than not to do so. Alternatively, it might be that suppliers prefer hiding benefits in the boilerplate because collusion over a uniform price would break down. One way or another, when we observe that suppliers chose to hide benefits in their boilerplate, such a practice always improves the prospects of collusion.

The analysis in this Section could also explain why many suppliers often include beneficial boilerplate terms in their contracts. In addition to the profits from discrimination, described in Section I.B, such a strategy could make collusion at the expense of nonreaders of boilerplate provisions more sustainable.

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of legal intervention, with the former type of collusion, the supplier extracts more surplus from consumers who do decide to purchase from the supplier.

#### D. Using Beneficial Boilerplate Terms as a Signaling Device

##### 1. Encouraging Anticompetitive Accommodation among Rivals

A related feature of beneficial boilerplate terms is that they can be used to encourage anticompetitive accommodation by rivals. By accommodation, we mean the opposite of exclusion. Even absent collusion, firms may sometimes compete vigorously with the hope of excluding their rivals and gaining dominance in the market in the long run. If they succeed in doing so, welfare may be reduced because the structure of the market would become less competitive. On the other hand, if they do not succeed in doing so, and the rivals, rather than being excluded, fight back with beneficial terms on their own part, welfare is considerably enhanced, as consumers enjoy extremely beneficial terms from all suppliers. In such cases, a supplier's forsaken hope of excluding a rival turns out to be welfare-enhancing.

Our claim here is that including beneficial boilerplate terms in the supplier's contracts could be a relatively cheap way to discourage welfare-enhancing (unsuccessful) attempts to exclude rivals. The previous Section discussed this effect in the context of the sustainability of tacit collusion, where an attempt to exclude a rival was seen as motivation for deviating from collusion. Here we wish to stress that this anticompetitive effect could remain even absent collusion. Take supplier Alpha from Example 10 above, which offered a beneficial discount only to readers of its boilerplate language. In doing so, Alpha sends a credible signal that it is efficient and competent enough to cope with such a discount for a long period. This discourages Beta from trying to compete vigorously, hoping to exclude Alpha.<sup>69</sup> Had Beta been in the dark about how far Alpha could go with such competitive terms, Beta might have competed vigorously, Alpha would have fought back by competing vigorously itself, their consumers would have benefited, and Alpha and Beta would have earned lower profits.<sup>70</sup>

##### 2. Entry Deterrence

Beneficial boilerplate terms could also be a device that incumbent firms use to deter entry of new rivals. The beneficial terms serve as a credible signal of the extent of benefits to consumers that the incumbent firm can cope with. Consider Example 10, in which both Alpha and Beta offer boilerplate terms with discounts. A potential entrant, Gamma, observes these terms and receives a credible signal as to how far Alpha and Beta could go with respect to all consumers in order to fight Gamma if it decides to enter. Absent

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69. As noted, *supra* note 67, although Alpha could try to "cheat" and disguise itself as an extremely efficient firm by offering below-cost discounts in the boilerplate terms, Alpha's signal still has considerable credibility.

70. As noted, *supra* note 67, if Beta is so efficient that it can profitably undercut even Alpha's beneficiary terms, exclusion would have occurred with or without the beneficial boilerplate terms. Therefore, there is no welfare-enhancing effect here in discouraging Beta from trying to exclude Alpha.

such beneficial boilerplate terms, if Gamma is imperfectly informed about Alpha and Beta's costs and capabilities, Gamma may place a positive probability on the possibility that Alpha and Beta are less efficient or capable than Gamma is. The odds that Gamma would indeed take its chances and enter are then greater. Once Gamma is in the market, it becomes harder for Alpha and Beta to drive Gamma out, as Gamma's costs of entry will have already been sunk.

On the other hand, beneficial boilerplate terms could signal to Gamma that Alpha and Beta are indeed efficient. The signal is credible because Alpha and Beta are already offering these terms to consumers who read the boilerplate provisions. If they do so for a relatively long period, it cannot be the case that they are not efficient enough or not capable of granting such terms without a loss.<sup>71</sup> Gamma then knows that if it enters the market, Alpha and Beta could offer the attractive terms to all consumers (readers and non-readers alike), thereby making entry less profitable and less likely. Absent the possibility of beneficial boilerplate terms, such entry deterrence through signaling becomes much more costly: Alpha and Beta need to offer better deals to all of their customers.

### III. CREATING FALSE APPEARANCES

#### A. *Creating an Illusion of a Fair Contract*

As noted in the Introduction, in most legal systems, standard-form contracts are subject to judicial review. When courts assess a value-reducing term in a standard-form contract, they consider the fairness of the contract in its entirety, and not only the particular term.<sup>72</sup> Accordingly, a supplier who wishes to minimize the chances that a certain term would be struck down would try to offset it with beneficial terms, which would help convince the court that the contract in its entirety is fair.

Such offsetting beneficial terms, however, are costly to the supplier. It would prefer to "kill two birds with one stone": on the one hand, keep the oppressive terms intact, and on the other, not have to bear the full cost of the offsetting beneficial terms. The supplier could achieve this by placing the beneficial terms in the boilerplate language, so that only those who read and fully understand them would actually enjoy them. The supplier can influence the number of customers that actually enjoy the beneficial terms by

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71. As noted, *supra* note 67, Alpha and Beta could try to look even more efficient than they actually are by offering below-cost terms to the readers of the boilerplate provisions. But such a strategy of incurring long-term losses (or sacrificing long-term profits) is often prohibitively costly.

72. See HUGH COLLINS, REGULATING CONTRACTS 260–66 (1999) (explaining that unfairness cannot be detected by analyzing specific terms as seemingly unfair because these terms are usually concessions granted in exchange for other advantages); Arthur Allen Leff, *Unconscionability and the Code—The Emperor's New Clause*, 115 U. PA. L. REV. 485, 541 (1967) ("[W]hen the question is presented as a decision as to the 'unconscionability' of a single contractual provision, the vacuousness of the standard is apparent.").

controlling the complexity of their apprehension and “hiding” them deeper in boilerplate language.<sup>73</sup> This is illustrated by Example 11:

*Example 11. Offsetting Benefits.* A dry cleaning firm sets a term in its standard-form contract according to which it will not be responsible for damages above a certain low threshold. Alongside this term is a boilerplate term providing that a customer interested in purchasing insurance could, for a fee, be insured for damages above this threshold, provided he fills out a certain form and mails it to the supplier.<sup>74</sup>

When attacked about the value-reducing features of the term exempting the supplier from liability, the supplier could point out the fact that it is offering any customer who is interested full insurance for a relatively low fee. The supplier could claim that his standard-form contract, viewed in its entirety, is fair, and, moreover, efficient, since it induces customers who may suffer damages above the low threshold to reveal themselves, and provides lower rates for those customers who do not expect to suffer such damages. The catch, however, is that this claim assumes complete information on the part of consumers. In reality, many consumers with potential damages would not be able to comprehend that the insurance option is worthwhile, and, moreover, they might not even be aware of the insurance option or of the exemption from liability, as both are placed in the boilerplate language. Moreover, the transaction costs a customer has to bear in order to assess the insurance option, fill out the required form, and mail it to the supplier may deter her from exercising this option, even if it is a fair one. Accordingly, the supplier could impose transaction costs and use boilerplate language in order to deter most customers from using the insurance option, while still being able to use this option as an offsetting benefit in court.

Many additional examples exist in which suppliers try to create the appearance of a fair contract while trying to avoid the corresponding costs. A typical example is that of contracts in which the customer has the option of canceling his subscription or enrollment within a certain trial period or the option of returning purchased merchandise. All the supplier needs to do in order to avoid most of the costs concerning these seemingly fair benefits granted to customers is to hide them in boilerplate language, make them difficult for customers to assess or understand, or impose transaction costs upon customers who wish to exercise the option.<sup>75</sup>

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73. Transaction costs that would cause all or most customers not to exercise the beneficial option would be an extreme case of the strategy discussed in the text. Costs that cause only some of the customers not to exercise the option possibly characterize cases in which the supplier wishes to price discriminate in favor of customers who exercise the option, *see supra* Section I.B, while still maintaining the appearance of a fair contract in case value-reducing terms in the contract are attacked in court.

74. CA 1/79 *Dry Cleaning Factories Keshet Ltd. v. Attorney General* [1980] IsrSC 34(3) 365. Also see the analogous terms in the standard-form contract of M.P.L., an Israeli firm, which provides storage services in the custom authority's warehouses (on file with the authors).

75. *See, e.g., supra* note 30 (describing the disconnection policy of the Internet service provider Speakeasy, found in its boilerplate provisions). Similarly, the standard-form contract of Moked Keshev Lev, an Israeli medical center offering its members urgent medical help services, allocates in

Finally, suppliers may want to maintain the appearance of a fair contract not only in the eyes of courts, but also in the eyes of the press, consumer organizations, or competitors who try to criticize the supplier for value-reducing terms in its standard-form contract. The supplier could then defend itself from such criticism by pointing out the offsetting beneficial terms, but still use transaction costs and boilerplate language in order not to bear the costs of providing the benefits.

### B. *Hiding Benefits from Third Parties*

At times, the supplier wishes to grant certain special benefits to a group of people who are parties to the supplier's standard contract, but is interested in hiding these benefits from third parties.

*Example 12. Hidden Benefits.* A university has a standard contract with faculty who are inventors. The contract determines the inventors' rights and grants them certain special benefits. The terms of the contract, however, are obscure and difficult to understand.

A possible explanation for the obscurity of the contract in Example 12 is that the university does not want faculty members who do not have a chance of being inventors to observe the extreme benefits granted to the inventors. Moreover, the obscurity of the contract could help prevent public criticism of the practice.

## IV. A CREDIBLE SIGNAL FOR NOT NEGOTIATING

In many cases a supplier would like to signal to his customers or his competitors that certain terms in the contract, or at times, the whole contract, are not negotiable. We claim that the supplier could impose transaction costs upon himself, usually with the aid of standard-form contracts, in order to credibly commit not to negotiate his contracts. Non-negotiability of contracts could serve various purposes. We focus here on three purposes that have received less attention.

### A. *Signaling Improved Incentives*

Non-negotiability of contractual terms could signal that the supplier's improved incentives, brought about by maintaining these terms in all or most of the supplier's contracts, remain intact.<sup>76</sup>

*Example 13. Warranty.* Joe is a car manufacturer who sells directly to customers. In his standard sales contracts, there is a two-year warranty. It is

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its boilerplate provisions a limited period of time for cancellation of the membership (on file with the authors). To be sure, at times suppliers may want to make the ability to cancel the contract salient in order to signal their confidence in the quality of their product or service. We are focusing here on different cases.

76. See Baird, *supra* note 6, at 2724 ("Unsophisticated consumers are often better off in a market in which no one can bargain for special terms than in a market where everyone can.").

important to Joe to signal to his customers that the warranty cannot be waived.

The reason it is important to Joe to signal to his customers that the warranty cannot be waived is that if it could be waived, it would cease to signal the car's quality. A warranty serves two main goals. First, it provides the customer with insurance, according to which if the car breaks down, the supplier would bear the costs of fixing it. But more importantly, a warranty signals the car's quality, since if the supplier bears the costs of fixing defects, he has an incentive to make a better and more reliable car. Many customers value the quality-signaling virtue of the warranty even more than they value the insurance aspect.<sup>77</sup> This is because typically not all of the customer's damages and inconvenience related to a defect would be covered. Moreover, the customer is interested in a reliable car with no defects for safety reasons as well, regardless of the insurance aspect.

However, in order for the warranty to credibly signal the car's quality and reliability, the customer has to know that the warranty applies to all or most customers. If many customers are expected to waive the warranty, the supplier's incentives to make a better car would be eroded, and the car's quality would diminish. Consumers would then insist on paying less for the car or would prefer a competing car. Indeed, any given customer may try to waive the warranty in exchange for a refund, in order to obtain a free ride on the supplier's improved incentives, supposedly achieved via the warranty granted to all other customers. Many customers would try to do so, however, so that the supplier's improved incentives would no longer exist.<sup>78</sup>

Accordingly, the supplier would be interested in credibly committing not to negotiate the warranty. One way to do so is to commit contractually not to negotiate. This would usually not be an effective commitment device, however, because customers would find it hard to monitor the supplier's relations with all its other customers. An alternative commitment device, which we are focusing upon here, is to use boilerplate provisions or standard-form contracts to make negotiation over the warranty particularly difficult and complicated. For example, the boilerplate provisions could provide that the warranty cannot be waived without prior approval by the CEO or the board, or without following a cumbersome process.

Alternatively, actual contacts with buyers could be made by the supplier's agents, and these agents could have no discretion to negotiate the contract. Typically, such a supplier will operate with standard-form contracts, the terms of which are rigid and not negotiable. Blocking negotiation by the supplier's agents could be achieved either by an explicit rule forbidding negotiation or by filling the boilerplate language with professional or legal jargon and employing agents that are not capable, or lack sufficient information or skills, to understand or negotiate the standard terms.

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77. Robert Cooter & Ariel Porat, *Anti-Insurance*, 31 J. LEGAL STUD. 203, 203–16 (2002).

78. *Id.* at 216–17.

Such mechanisms could serve as a credible commitment on the part of the supplier not to negotiate. Even if the supplier's agent tries to circumvent the complicated process and waive a warranty in exchange for a discount, the customer would hesitate to cooperate out of fear that such negotiated terms are void due to the circumvention of the required process.

State laws often enable suppliers to submit their standard contracts to a certain agency or to the state's attorney general for approval.<sup>79</sup> Such submission of a supplier's standard contracts enhances their rigidity and negotiation-proofness. This is because any subsequent change of the contract's terms would require resubmission to the state agency for new approval in order to enjoy the legal defenses inherent in such approval. Also, a very convincing way for a supplier to signal to consumers that negotiating the contract is impossible is by making the transaction through the Internet, where, obviously, no live agent conducts any type of negotiation.<sup>80</sup>

### B. Signaling to Commercial Buyers about Uniformity of Terms

Another case in which a supplier would want to impose upon himself and his customers costs of negotiating terms is when the supplier wishes to signal to its customers that prices, or other terms, are uniform for all customers. The following example illustrates this point:

*Example 14. Nondiscrimination Commitment.* Firm X manufactures refrigerators and sells them through various dealers. X is interested in committing toward the dealers that no dealer is receiving special benefits compared to other dealers.

The reason it is important for X to commit not to discriminate between dealers is that if a dealer suspects that X is granting special benefits or discounts to another dealer, the first dealer might hesitate to do business with X or might insist on doing business with X on terms less favorable to X.<sup>81</sup>

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79. See, e.g., Plain Language Contract Act, MINN. STAT. ANN. §§ 325G.29–.36 (West 2004 & Supp. 2006). Section 325G.35, entitled "Review by the attorney general" states: "Any seller, creditor or lessor may submit a consumer contract to the attorney general for review as to whether the contract complies with the requirements of section 325G.31 . . . . Any consumer contract certified pursuant to subdivision 1 is deemed to comply with section 325G.31 . . . ."

80. See Hillman & Rachlinski, *supra* note 3, at 468 ("[E]-consumers cannot negotiate because web pages and installation software do not allow for interaction with a live agent.").

81. The supplier may also want to credibly commit to noncommercial consumers that he will not discriminate among them. End consumers who fear that they could be discriminated against could feel deceived or believe that the supplier is using them to subsidize other consumers. Novell, a large seller of infrastructure software and services software, states in its agreement for the sale of Secure Login that: "NO LICENSOR, DISTRIBUTOR, DEALER, RETAILER, RESELLER, SALES PERSON, OR EMPLOYEE IS AUTHORIZED TO MODIFY THIS AGREEMENT OR TO MAKE ANY REPRESENTATION OR PROMISE THAT IS DIFFERENT FROM, OR IN ADDITION TO, THE TERMS OF THIS AGREEMENT." Novell, *supra* note 29. Such a term, coupled with the fact that Novell operates with the standard contract from which this term was taken, helps Novell credibly commit not to negotiate. Other examples consist of firms selling according to a standard pricelist, which is distributed to all buyers along with a firm statement that prices are fixed. Negotiating the standard price is difficult, particularly when deals are made via the internet. Examples include the price list of Easy Garden, a gardening store marketing via the Internet, Easy

Interestingly, the economics literature finds that even suppliers with market power or a monopoly position might opportunistically grant benefits to one commercial buyer at the expense of another buyer competing with the first buyer, and that such opportunism causes all buyers to pay the supplier lower prices across the board.<sup>82</sup> In order to prevent the price the supplier is able to charge from decreasing in such a manner, it would be in his interest to make a commitment not to make concessions to one buyer at the expense of another.

One way X can promise not to grant discriminatory benefits is to commit contractually not to discriminate. However, such a commitment is difficult to enforce, and complicated monitoring mechanisms would have to be constructed.<sup>83</sup> Such mechanisms could also be relatively easily circumvented by X, by offering subtle or disguised benefits. Accordingly, a possibly more credible way for X to commit not to discriminate is by developing uniform contracts and boilerplate provisions that are difficult for X to negotiate.<sup>84</sup>

### C. Signaling to Competitors about Uniformity of Terms

Industry mavericks can credibly commit to becoming less eager to cut prices by making the terms of sale rigid and costly to change. Suppose firm X, from Example 14 above, is an industry maverick. Recall from Section II.A that an industry maverick would often like to commit to being less aggressive in order to induce his rivals to compete less aggressively as well.

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Garden, Master Price List (Jan. 1, 2005), <http://www.easy-garden.com/masterpricelist.htm> (listing prices for gardening supplies and portable poultry shelters), the price list of Entran, a manufacturer of sensors and electronics, Entran, Accelerometer Price List, <http://www.entran.com/pl/plausa.htm> (last visited Nov. 26, 2005), and the detailed price list of TreePad, TreePad Price List, <http://www.treepad.com/pricelist/> (last visited Nov. 26, 2005) (listing prices for its personal information manager program and Word Processor) .

82. See David Gilo, *Retail Competition Percolating Through to Suppliers and the Use of Vertical Integration, Tying, and Vertical Restraints To Stop It*, 20 YALE J. ON REG. 23, 25–75 (2003); Oliver Hart & Jean Tirole, *Vertical Integration and Market Foreclosure*, BROOKINGS PAPERS ON ECON. ACTIVITY: MICROECON., 1990, at 205; R. Preston McAfee & Marius Schwartz, *Opportunism in Multilateral Vertical Contracting: Nondiscrimination, Exclusivity, and Uniformity*, 84 AM. ECON. REV. 210 (1994); Daniel P. O'Brien & Greg Shaffer, *Vertical Control with Bilateral Contracts*, 23 RAND J. ECON. 299, 305 (1992).

83. Indeed, the statutory ban on secondary-line price discrimination, included in Section 1(a) of the Robinson-Patman Act, 15 U.S.C. § 13(a) (2000), forbids a supplier from discriminating between competing dealers. This prohibition, however, is difficult to enforce, and infringements are difficult to observe or verify in court. A related practice is that of “most favored-consumer clauses,” clauses according to which a supplier promises all buyers that if one receives a discount, all of the others will receive the same discount. Such clauses too are difficult and costly to implement, and, at times, could draw unwanted antitrust attention. See Jonathan B. Baker, *Vertical Restraints with Horizontal Consequences: Competitive Effects of “Most-Favored-Customer” Clauses*, 64 ANTI-TRUST L.J. 517 (1996); Thomas E. Cooper, *Most-Favored-Customer Pricing and Tacit Collusion*, 17 RAND J. ECON. 377 (1986); Gilo, *supra* note 82, at 67–69.

84. Indeed, McAfee and Schwartz claim that franchisors use uniform and rigid contracts with franchisees in order to better commit to not negotiate them. However, they discuss uniformity alone, rather than mechanisms that raise the costs of negotiation. McAfee & Schwartz, *supra* note 82, at 213.

Firm X could often make more from price cutting (and therefore be more aggressive) if its price cuts could be kept secret (for example, by renegotiating the terms of the contract only with a small group of large and discrete dealers), since then its rivals would react more slowly, if at all, and X's short-term gain from price cutting would be greater. Of course, X could cut prices (or offer an analogous benefit to buyers) by changing the terms of its standard-form contract across the board. Such a price cut, however, would be easier for X's rivals to detect quickly, and, accordingly, they would respond quickly, by price cutting themselves. Therefore, operating with rigid standard-form contracts and raising the transaction costs of negotiating the contract with buyers can serve as a credible commitment by X not to cut prices, since it makes the price cut more transparent to X's rivals.<sup>85</sup> This could facilitate tacit collusion in X's industry if X is an industry maverick.

#### V. THE LEGAL IMPLICATIONS OF HIDING BENEFITS IN THE BOILERPLATE

Identifying the various uses of boilerplate language and artificial transaction costs imposed on buyers raises the question of whether these uses are desirable from a social point of view. If the answer is negative, a second question arises: should the law intervene, and if so, by what means? The analysis in Parts I–IV reveals that there are two specific practices that may raise legal concerns that have been ignored by the current literature and by courts. The first is the practice of artificially complicating the transaction in ways that benefit suppliers at the expense of buyers, and the second is the practice of hiding benefits in the boilerplate. In what follows, we shall focus on the policy implications of the latter.

Throughout Parts I–III above, we have shown that hiding benefits in the boilerplate could benefit suppliers at the expense of some or all buyers in various ways. First, as shown in Section I.B, hidden benefits could be used to price discriminate between readers of the boilerplate and nonreaders. Second, as shown in Sections II.C and II.D, beneficial boilerplate terms could be used by suppliers to harm competition. Finally, as shown in Section III.A, suppliers could hide benefits in the boilerplate in order to create the illusion of a fair contract. Let us separately explore the policy implications of each of these three uses of beneficial boilerplate terms. Such an analysis will help us advise courts as to how they could cope with cases of beneficial boilerplate terms that raise policy concerns.

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85. With regard to most-favored-consumer clauses, discussed *supra* note 83, the literature has indeed implied that they could facilitate tacit collusion. See Baker, *supra* note 83, at 519–20; Cooper, *supra* note 83. As noted, however, such clauses are difficult to implement and could draw antitrust scrutiny, while plain rigidity and difficulty of negotiation could more easily and credibly be implemented and does not currently draw antitrust attention. Therefore, the supplier may prefer using transaction costs and rigidity.

### A. Price Discrimination

The practice of price discrimination through boilerplate provisions could raise objections from two different perspectives. The first is the social-policy perspective; the second is the perspective of the relationship between the supplier and the consumer who was adversely affected by the discrimination. We shall discuss these two perspectives separately.

*Social Welfare Perspective.* If the supplier were able to charge each consumer exactly what the consumer was willing to pay ("perfect price discrimination") such pricing would be socially efficient and superior to uniform pricing since all consumers who value the product more than the marginal costs of supplying it would receive the product.<sup>86</sup> The kind of discrimination achieved by hiding benefits in boilerplate provisions, however, is an imperfect kind. The supplier is unaware of each and every consumer's willingness to pay. The only thing he is assumed to realize here is that consumers who are ready to incur the transaction costs of reading, understanding, and remembering benefits hidden in boilerplate provisions ("readers") are, on average, willing to pay less (or unwilling to receive less value) than nonreaders.

Accordingly, for example, if the uniform price the supplier would set absent discrimination is \$90, by hiding benefits in boilerplate provisions, he is induced to set a posted price larger than \$90 (say, \$100) to nonreaders and to offer readers a price lower than \$90 (say, \$80). He can do so by offering readers a special discount of \$20 off the posted price of \$100. It may be, however, that some readers would have purchased the product even for the uniform price of \$90, while some nonreaders, who would have purchased the product for \$90, end up not purchasing the product for the posted price of \$100.

This imperfection of discrimination via boilerplate provisions potentially causes two kinds of welfare losses. The first stems from nonreaders who would have purchased the product for \$90, but would not purchase it for \$100. Their valuation for the product (of between \$90 and \$100) is above the marginal costs of producing it (which are clearly below the uniform price of \$90), but discrimination via boilerplate provisions causes them not to purchase the product. The larger the number of such consumers (nonreaders whose valuation of the product is between \$90 and \$100), the greater the deadweight loss caused by discrimination via boilerplate provisions.

The second welfare loss stems from the transaction costs imposed by the boilerplate provisions and born by readers who would have purchased the product even for the uniform price of \$90, but are induced to read the boilerplate provisions in order to receive the special discount. The fact that they earn the discount of \$20 is a mere transfer from the supplier to them, while the transaction costs expended on reading, understanding, and remembering the boilerplate provisions are a deadweight loss. This loss could have been

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86. See TIROLE, *supra* note 40, at 136.

avoided absent discrimination via the discount hidden in the boilerplate language. The larger the number of such consumers (readers who value the product more than \$90), the larger the welfare loss. A related welfare loss involves accidental readers—those who read the boilerplate provisions but ultimately decide not to purchase despite the discount. Such “accidents” may occur since consumers cannot grasp the full extent of the benefit hidden in boilerplate provisions until they actually bear most of the transaction costs involved. The harder it is for a consumer to predict the extent of the benefit from just skimming the boilerplate provisions, the larger the probability of such an accident (and the larger the related welfare loss). All transaction costs’ related losses are of course larger the more costly it is for a consumer to read, understand, and remember the benefit embedded in boilerplate provisions.

These welfare losses should be compared to the welfare gain from hiding the discount in the boilerplate provisions. This gain is attributable to readers who would not have purchased the product for the uniform price of \$90 and are induced to purchase it for \$80 on account of the discount. The more readers who value the product between \$80 and \$90, the larger this welfare gain. From this welfare gain one has to subtract, however, the transaction costs such readers need to bear in order to utilize the discount.

Admittedly, in a given case, it would be difficult for a court to assess and compare the welfare losses and gains. In order to do so, it would be helpful to assess whether the number of units the supplier sells expanded following the practice of hiding benefits in boilerplate provisions. If the number of units expanded, it would make a case in favor of nonintervention. On the other hand, if the number of units diminished following the practice, there is a strong case in favor of banning it. Such evidence implies that the practice caused more nonreaders to stop purchasing than it caused readers to start purchasing. On top of these considerations, one should take account of the loss involved in the transaction costs of reading the boilerplate provisions. But an *ex post* examination of whether the supplier supplies more or fewer units following the practice of discriminating via beneficial boilerplate terms is extremely difficult. This is because there are several other factors, unrelated to the practice, which could affect the number of units he supplies, including shifts in demand, cost, brand loyalty, and the intensity of competition.

The distributive effects of discrimination via boilerplate provisions could also be of interest. Obviously, discrimination transfers value from nonreaders to readers and suppliers. The distributive concerns therefore hinge on the identity of readers versus the identity of nonreaders. In many cases, readers are the less fortunate consumers—those with lower means, unsteady jobs, and more time on their hands. In such cases, egalitarian concerns work in favor of permitting discrimination via boilerplate provisions. In other cases, readers could consist predominantly of repeat purchasers or sophisticated customers. Here it is less obvious whether it would be advis-

able for such customers to be enriched at the expense of nonreaders, who are one-time or less sophisticated customers.<sup>87</sup>

What are the welfare effects of the “drawing mode” of price discrimination via boilerplate provisions? Recall that with this type of price discrimination, the supplier “draws” the benefits in favor of some consumers, particularly those who are on the verge of not purchasing the product. This type of discrimination arguably causes even fewer welfare losses than the previous type, since the supplier “cherry picks” consumers with low willingness to pay according to their behavior. Many nonreaders who would not have purchased the product would be induced to purchase it in the drawing mode. Furthermore, transaction costs incurred in reading the boilerplate provisions are expected to be smaller, as the supplier assists some consumers by making the benefits hidden in the boilerplate provisions salient. Accordingly, there is an even stronger case for nonintervention in the drawing mode of price discrimination than there is in the nondrawing mode discussed above.

The above welfare analysis implies that it would be extremely difficult to identify cases in which discrimination via boilerplate language is welfare-reducing. Accordingly, we believe that intervention should particularly hinge not merely on the discriminatory nature of beneficial boilerplate terms but rather on their other two uses: harming competition and creating the appearance of a fair contract. Still, total welfare effects notwithstanding, one should consider how and when current doctrines concerning the supplier-consumer relationship could be applied to discrimination via boilerplate.

*Supplier-Consumer Perspective.* One possible claim a nonreader could invoke against the supplier is that the supplier failed to disclose to him that other consumers got a better deal than the one he got. In particular, the nonreader could claim that this undisclosed fact is a material part of the bargain, and since the supplier failed to disclose it, the consumer is entitled to rescind the contract or even sue for damages or enforce the beneficial terms in his favor. More specifically, such a consumer would attempt to argue that the supplier should have revealed to him that there were benefits hidden in boilerplate provisions.

There are numerous consumer protection statutes that impose duties of disclosure. However, most of these statutes oblige suppliers to disclose exclusionary clauses, limitations on explicit or implicit warranties, and many other terms that could constitute “a (bad) surprise” to a consumer who does not, or cannot, read boilerplate provisions carefully enough.<sup>88</sup> Such statutes

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87. It could be asked how discrimination via boilerplate language compares with other forms of imperfect price discrimination (that is, discrimination based on other proxies for a person’s willingness to pay, such as age, occupation, and so forth). One notable point in this respect is that since discrimination via boilerplate language does not directly hinge on a consumer’s characteristics, and since in this type of discrimination most consumers who are discriminated against are actually unaware of it, this form of discrimination arguably causes less consumer frustration than other types.

88. For instance, the Truth in Lending Act is aimed at increasing disclosure of credit costs to borrowers. Truth in Lending Act, 15 U.S.C. §§ 1601–07(c) (2000). Similarly, the Equal Credit Opportunity Act mandates that an applicant for credit is entitled to disclosures explaining the reasons

are not relevant to our case, since we are dealing here with “good” surprises—and not “bad” surprises—the consumer was unaware of.

Other statutes, prevailing in several states, impose a duty on suppliers to draft consumers’ contracts in plain language.<sup>89</sup> Such statutes could be of relevance to us, as long as the transaction costs consumers need to incur in order to reveal the benefits in boilerplate provisions stem from difficulties in understanding the wording of the contract. The plain-language statutes are not relevant, however, to cases where the difficulties lie in the length of the boilerplate language, the short time the consumer can dedicate to reading and understanding it, or her efforts in remembering to take the necessary steps in order to receive the benefits after entering into the contract.

The common law also imposes upon a supplier a duty of disclosure in appropriate cases. In certain special cases, the consumer may have reasonable expectations—stemming from his special relationship with the supplier or from a promise or representation made by the supplier—that he would disclose any material fact of the bargain to the consumer.<sup>90</sup> A special relationship could also be deduced from the ongoing or long-term relationship between the supplier and the consumer, which gives rise to a duty of disclosure.<sup>91</sup> In such special cases, regardless of the welfare analysis we conducted above, there could be grounds under contract law for the consumer to rescind the contract due to nondisclosure of the hidden benefits,<sup>92</sup> and even, in

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why credit has been denied or revoked. Equal Credit Opportunity Act, 15 U.S.C. § 1691(a)–(f) (2000). The Real Estate Settlement Procedures Act requires preparation and distribution of booklets that explain the nature and costs of real estate settlements. Real Estate Settlement Procedures Act, 12 U.S.C. §§ 2601–07 (2000). Finally, the Interstate Land Sales Full Disclosure Act requires, among other things, a statement of record describing those with interests in the land, all conditions and plans with respect to the land, and the types of sales and transactions contemplated. Interstate Land Sales Full Disclosure Act, 15 U.S.C. §§ 1701–20 (2000).

89. See, e.g., Plain Language Contract Act, MINN. STAT. ANN. §§ 325G.29–.36 (West 2004 & Supp. 2006). Several other states have adopted similar laws. See, e.g., Consumer Contract Awareness Act of 1990, CAL. CIV. CODE §§ 1799.200–.206 (West 1998); CONN. GEN. STAT. §§ 42-151 to 42-158 (2005); DEL. CODE ANN. tit. 6 §§ 2731–36 (1999); HAW. REV. STAT. §§ 487-1 to -4 (1995); Plain Language in Contracts Act, MONT. CODE ANN. §§ 30-14-1101 to -1104, -1111 to -1113 (2005); N.J. STAT. ANN. §§ 56:12-1 to -86 (West 2001 & Supp. 2005); N.Y. GEN. OBLIG. LAW § 5-702 (McKinney 2001); 69 PA. CONS. STAT. ANN. §§ 1201–12 (West 2004); W. VA. CODE ANN. § 46A-6-109 (LexisNexis 1999).

90. See generally *United States ex rel. Bussen Quarries, Inc. v. Thomas*, 938 F.2d 831, 834 (8th Cir. 1991); *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. First Nat’l Bank of Little Rock, Ark.*, 774 F.2d 909, 913 (8th Cir. 1985); RESTATEMENT (SECOND) OF CONTRACTS § 161 (1981); RESTATEMENT (SECOND) OF TORTS § 551 (1977); JOHN D. CALAMARI & JOSEPH M. PERILLO, *THE LAW OF CONTRACTS* § 9.20, at 337 (4th ed. 1998); FARNSWORTH, *supra* note 2, § 4.15.

91. See generally Ian R. Macneil, *Bureaucracy and Contracts of Adhesion*, 22 OSOODE HALL L.J. 5, 20–22 (1984) (describing consumers’ transactions as a long-term bureaucratic contractual relationship).

92. See RESTATEMENT (SECOND) OF CONTRACTS § 303(b); RESTATEMENT OF RESTITUTION § 8 cmt. e, 28 (1937); FARNSWORTH, *supra* note 2, §§ 4.11, 4.15 (discussing the effects of nondisclosure and the remedies for misrepresentation).

appropriate cases, to sue for damages or enforcement of the beneficial terms on his behalf.<sup>93</sup>

### B. Using Beneficial Boilerplate Terms to Harm Competition

As demonstrated in Section II.C, when suppliers place beneficial terms in boilerplate language, tacit or explicit collusion could be more sustainable than when such a practice is banned. Note that when the practice is banned, if collusion breaks down, nonreaders and readers of the boilerplate provisions alike enjoy competitive terms. This means that the collusion-facilitating characteristic of creating beneficial boilerplate terms is unambiguously harmful. Recall also that, in Example 10, even if only supplier Alpha has beneficial boilerplate provisions while Beta is the industry maverick, such a practice could facilitate collusion and therefore be harmful. Even if Alpha is the industry maverick, the practice would facilitate collusion when it raises Alpha's collusive profits due to its discriminatory attributes.<sup>94</sup>

Similar are the anticompetitive harms from beneficial boilerplate provisions that encourage anticompetitive accommodation by rivals or deter entry, as discussed in Section II.D, above. The fear of anticompetitive accommodation and entry deterrence takes place in cases similar to those referred to above in the discussion of collusion: industries with only a few substantial players. In such industries, tacit collusion is likely and imperfect competition is abundant; failed attempts by suppliers to exclude their rivals, as well as entry of new firms, are welcome, as they could dissipate supra-competitive pricing.

Accordingly, while the mere discriminatory characteristics of beneficial boilerplate terms do not justify intervention (subject to cases involving special relationships between the supplier and the customer),<sup>95</sup> when beneficial boilerplate terms are adopted by suppliers in an oligopolistic setting, the case for legal intervention is strengthened due to the potential anticompetitive effects. Naturally, the most appropriate legal tools to deal with such effects are the antitrust laws.

Section 1 of the Sherman Act, which prohibits restraints of trade, requires an agreement between at least two entities for it to be violated. In

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93. See RESTATEMENT (SECOND) OF TORTS § 551 ("The party in the wrong is liable for the loss caused to the injured party by its reliance on the misrepresentation, promise, or undertaking in question. . . ."); FARNSWORTH, *supra* note 2, § 4.15.

When the beneficial boilerplate term involves warranties, a suit by a nonreader may be brought also for breach of an implied warranty. See Magnuson-Moss Warranty Act §§ 104, 108, 15 U.S.C. §§ 2304(e), 2308 (2000) (stating that the supplier cannot disclaim implied warranties, and if the supplier designates a written warranty as "full," it must meet stated requirements, including an undertaking to provide a remedy without charge by repair, replacement, or refund); FARNSWORTH, *supra* note 2, at § 4.29; see also MD. CODE ANN., COM. LAW § 2-316.1 (LexisNexis 2002); MASS. ANN. LAWS ch. 106, § 2-316A (LexisNexis 1998) (prohibiting disclaimers of implied warranties).

94. See *supra* note 67 and accompanying text (describing how beneficial boilerplate terms could raise the collusive profits of the supplier adopting them, thereby deterring him from deviating from collusion).

95. See *supra* notes 90–92 and accompanying text.

contrast, hiding benefits in boilerplate language seems to be a strictly unilateral action. A rather bold and convention-breaking approach could be to draw an analogy between hiding benefits in boilerplate language and exclusive-distribution agreements. In an exclusive-distribution agreement, a supplier commits toward buyer A that he will not sell to buyer B. Such agreements could violate section 1 of the Sherman Act where their potential harm to competition outweighs their benefits to consumers.<sup>96</sup> An analogous agreement is one where the supplier makes a commitment to buyer A that buyer A will receive benefits that buyer B will not receive.<sup>97</sup> Creating beneficial boilerplate provisions, available only to those who read, understand, and remember them resembles the latter kind of agreement: by imposing prohibitive transaction costs on one group of consumers (those who do not read boilerplate language), the supplier makes a commitment to another group of consumers (those who do read boilerplate language) that only they will receive the benefits. From a public policy point of view, there should be no difference between the way antitrust law deals with this practice and the way it deals with two-sided vertical agreements that achieve similar outcomes.

One possible way to tackle the above-mentioned doctrinal problem regarding Sherman Act section 1's agreement requirement is to use section 5 of the Federal Trade Commission Act, empowering the Federal Trade Commission ("FTC") to intervene in cases of "unfair methods of competition . . . and unfair or deceptive acts or practices."<sup>98</sup> Hiding benefits in boilerplate language in a way that facilitates collusion, encourages anticompetitive accommodation, or deters entry, could be regarded both as an "unfair method of competition" and as an "unfair or deceptive practice."<sup>99</sup>

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96. See, e.g., *Packard Motor Car Co. v. Webster Motor Car Co.*, 243 F.2d 418 (D.C. Cir. 1957).

97. Such an agreement is the flip side of a "most-favored-consumer" agreement, according to which the supplier commits to buyer A that if buyer B receives a benefit, buyer A will receive the same benefit. Such agreements have been claimed to be subject to section 1 of the Sherman Act. See, e.g., Baker, *supra* note 83.

98. Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (2000).

99. The FTC, however, did not succeed in using section 5 to ban "most-favored-consumer" clauses or uniform-delivered pricing. In *E.I. Du Pont de Nemours & Co. v. FTC*, 729 F.2d 130, 130 (2d Cir. 1984), the Second Circuit reversed the FTC's decision that various facilitating practices, including uniform-delivered pricing, most-favored-customer contracts, and advance notice of price increases, violated section 5 of the FTC Act. The court based its conclusion, in part, on the fact that there was no evidence of the absence of an independent legitimate business reason for the defendant's conduct. *Id.* at 140. See generally Donald S. Clark, *Price-Fixing Without Collusion: An Antitrust Analysis of Facilitating Practices after Ethyl Corp.*, 1983 Wis. L. REV. 887, 890 (outlining the economic and legal attributes of facilitating practices and explaining the circumstances in which they could facilitate price and output coordination).

Furthermore, the FTC has attempted to attack price signaling as an illegal facilitating practice under section 5 of the FTC Act. In three complaints (all of which were eventually settled), the FTC alleged that certain "invitations-to-collude" constituted unfair methods of competition. In each of those cases, the defendants had solicited their rivals to engage in a price-fixing conspiracy by signaling their intentions to price at a particular level. See *YKK (U.S.A.) Inc.*, [1993-1997 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 23,355 (Fed. Trade Comm'n July 1, 1993) (consent order) (dealing with a supplier's request that his competitor stop offering free equipment to customers); *AE Clevite, Inc.*, [1993-1997 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 23,354 (Fed. Trade Comm'n

Indeed, the Supreme Court has interpreted section 5 broadly, holding that: “[T]he Commission has broad powers to declare trade practices unfair. This broad power . . . is particularly well established with regard to trade practices which conflict with the basic policies of the Sherman and Clayton Acts even though such practices may not actually violate these laws.”<sup>100</sup> Accordingly, section 5 of the FTC Act, as interpreted by the courts, is well suited to cover cases in which public policy warrants intervention, while Sherman Act section 1, if strictly interpreted, falls short of applying to the case due to its strict requirement for a two-sided agreement.

An alternative approach would be to allow nonreaders of boilerplate language to attack the supplier under the statutes or common law regarding the supplier’s disclosure requirements. Recall that we concluded in Section V.A.2 above, that such an approach would usually be unwarranted if the plaintiff’s sole claim was that he was the victim of price discrimination. In cases in which the practice facilitates cartels, raises prices, or deters entry, however, intervention through disclosure rules becomes warranted. In particular, the claim would be that beneficial boilerplate terms harm nonreaders not only by discriminating against them, but by facilitating noncompetition over the terms they receive. Absent the practice, collusion would have been more likely to break down, failed attempts to exclude rival suppliers and new entry would have driven prices down, and nonreaders and readers of boilerplate language alike would then have enjoyed competitive terms.

Another doctrine based on contract law that could be used to fight beneficial boilerplate provisions that harm competition is the ability to declare contracts with nonreaders unenforceable for public policy considerations, as is done with some other types of anticompetitive agreements.<sup>101</sup>

Hiding benefits in boilerplate language in a way that harms competition could also be attacked, in our opinion, as illegal price discrimination under the Robinson-Patman Act or similar state laws prohibiting price discrimination that may harm competition. Recall that discrimination between readers and nonreaders of boilerplate terms is the driving force behind the anticompetitive effects. The Robinson-Patman Act provides, in relevant part, that “[i]t shall be unlawful . . . to discriminate in price . . . where the effect of such discrimination may be substantially to lessen competition.”<sup>102</sup> Indeed, a

June 8, 1993) (consent order) (dealing with a supplier’s statement to his competitor that the competitor’s low prices were “ruining the marketplace”); *Quality Trailer Prods. Corp.*, [1987–1993 Transfer Binder] Trade Reg. Rep. (CCH) ¶ 23,246 (Nov. 5, 1992) (consent order) (same).

100. *FTC v. Brown Shoe Co.*, 384 U.S. 316, 320–21 (1966).

101. *See* RESTATEMENT (SECOND) OF CONTRACTS § 188 (1981) (“A promise to refrain from competition that imposes a restraint that is ancillary to an otherwise valid transaction or relationship is unreasonably in restraint of trade . . .”). *See generally* GRACE MCLANE GIESEL, 15 CORBIN ON CONTRACTS § 80.6, at 63–65 (Joseph M. Perillo ed., rev. ed. 2003).

102. 15 U.S.C. § 13(a) (1994). Section 5(a) of the Federal Trade Commission Act, 15 U.S.C. § 45(a)(1) (2000), has been construed as containing an overlapping prohibition of discrimination. *See* *FTC v. Motion Picture Adver. Serv. Co.*, 344 U.S. 392, 394–95 (1953); *Standard Oil Co. v. FTC*, 340 U.S. 231, 239–42 (1951). State statutes banning price discrimination or unfair competition could also be invoked. *See, e.g.*, COLO. REV. STAT. § 6-2-102 (2004); CONN. GEN. STAT. § 42-110b

supplier hiding benefits in boilerplate language charges different prices (or offers different qualities)<sup>103</sup> to readers and nonreaders.<sup>104</sup>

The supplier could claim, in its defense, that beneficial boilerplate provisions do not constitute price discrimination because all consumers have the opportunity to enjoy them. Although it could be claimed that nonreaders could have also enjoyed the benefits if they only took the time and effort to read, understand, and remember the boilerplate provisions, in reality they find the transaction costs of doing so prohibitively costly. Their situation bears some resemblance to commercial buyers who are too small for a supplier's quantity discounts to be functionally available to them. Such commercial buyers have been held by the Supreme Court to be victims of illegal price discrimination inherent in the quantity discounts.<sup>105</sup> This is notwithstanding the fact that these buyers could have been eligible for the quantity discount had they borne certain costs, such as the costs of expanding, buying quantities they did not need, or buying cooperatively.

Finally, when it is a dominant firm that hides benefits in its boilerplate language and this tends to deter the entry of new firms, as illustrated in Section II.D.2, this dominant firm could be accused of illegal monopolization under section 2 of the Sherman Act. This section can encompass unilateral actions by a dominant firm that help enshrine its dominance.<sup>106</sup> Since this section also applies to unilateral actions,<sup>107</sup> the above-mentioned doctrinal

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(2005) (for unfair competition); CONN. GEN. STAT. § 35-45 (2005); UTAH CODE ANN. § 13-5-3 (2005) (for price discrimination).

103. To the best of our knowledge, however, the Robinson-Patman Act's ban of price discrimination has not been applied to quality discrimination. Since quality and price are equivalent discriminatory tools in various contexts, such an application, in the types of cases discussed in the text, would be warranted.

104. The Robinson-Patman Act deals with several kinds of injury: injury to competition between suppliers ("primary line cases"), injury to the supplier's commercial buyers who suffered a competitive disadvantage due to the supplier's discrimination in favor of another commercial buyer ("secondary line cases"), and injury to the buyers' buyers from such discrimination ("tertiary line cases"). See FREDERICK M. ROWE, PRICE DISCRIMINATION UNDER THE ROBINSON-PATMAN ACT 141, 172-73 (S. Chesterfield Oppenheim ed., 1962). The kind of injury discussed here is that of primary line cases, since the harm to competition is between the supplier practicing discrimination via the boilerplate provisions and his rivals. Presumably, secondary line and tertiary line cases are less relevant in the current context, since commercial buyers are usually induced to read benefits placed in the supplier's boilerplate language.

105. See *FTC v. Morton Salt Co.*, 334 U.S. 37, 42 (1948); Edlin, *supra* note 26, at 559 n.102 (making a similar claim in favor of banning price matching as illegal price discrimination). Although cases such as *Morton Salt* deal with discrimination against commercial buyers ("secondary line cases"), they are applicable here too, since they discuss the fundamental question of whether price discrimination has occurred. This question is equally relevant to primary line cases, such as the case before us.

106. See, e.g., *Eastman Kodak Co. v. Image Tech. Servs., Inc.*, 504 U.S. 451, 481 (1992); *Walker Process Equip., Inc. v. Food Mach. & Chemical Corp.*, 382 U.S. 172, 174 (1965); *United States v. E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 391-92 (1956); *Data Gen. Corp. v. Gruman Sys. Support Corp.*, 36 F.3d 1147, 1181-82 (1st Cir. 1994); *United States v. Microsoft Corp.*, 87 F. Supp. 2d 30, 36 (D.D.C. 2000).

107. The Supreme Court has held:

hurdle regarding the agreement requirement of Sherman Act section 1 does not exist.

Naturally, intervention becomes more and more warranted the more concentrated is the industry (that is, the fewer significant players there are in the relevant market), the more significant are the suppliers who adopted the beneficial boilerplate terms, and the more abundant is the practice among suppliers. If the court finds that the relevant market is open to the entry of new significant firms or the expansion of currently insignificant firms, and that such entry or expansion is likely in the near future (even after taking account of the possible entry-detering effect of beneficial boilerplate terms), then intervention becomes less warranted.

To be sure, we are not advocating here a *per se* prohibition of beneficial boilerplate terms adopted by oligopolistic suppliers. Suppliers should be allowed to claim, in a particular case, that the practice involves welfare-enhancing attributes that outweigh the potential anticompetitive harm. The court would then face the nontrivial task of balancing the probable anticompetitive threat and the welfare-enhancing benefits. Such balancing is extremely familiar to courts in antitrust cases involving conduct that is not illegal *per se* but still raises considerable anticompetitive concerns.<sup>108</sup>

### C. *Creating an Illusion of a Fair Contract*

Section V.A, above, showed that the discriminatory attributes of beneficial boilerplate terms, in and of themselves, do not warrant intervention, and Section V.B showed how beneficial boilerplate terms adopted by oligopolistic suppliers could warrant intervention on account of their potential anticompetitive effects. At times, however, beneficial boilerplate terms raise policy concerns even absent an oligopolistic setting, when they are used by the supplier to create a false appearance of a fair contract by introducing beneficial terms that are not enjoyed by most consumers. Courts that review standard-form contracts should be aware of this. Therefore, when courts consider a standard-form contract, they should look not only at the appearance of the contract and at its theoretical potential to be fair, but rather at its

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The Sherman Act contains a “basic distinction between concerted and independent action.” The conduct of a single firm is governed by § 2 alone and is unlawful only when it threatens actual monopolization. . . .

Section 1 of the Sherman Act, in contrast, reaches unreasonable restraints of trade effected by a “contract, combination . . . or conspiracy” between *separate* entities. It does not reach conduct that is “wholly unilateral.”

Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 767–68 (1984) (citations omitted) (second omission in original); *see also* Monsanto v. Spray-Rite Serv. Corp., 465 U.S. 752, 761 (1984).

108. On top of such a balancing test based on a total welfare perspective, courts would occasionally need to address contractual doctrines concerning a special relationship between the supplier and a particular buyer. *See supra* notes 90–92 and accompanying text.

fairness in fact, given the transaction costs imposed on consumers who may want to enjoy its beneficial terms.<sup>109</sup>

For example, if while litigating a standard-form contract, the supplier tries to emphasize a term that gives consumers a way out of the transaction, the court should consider whether most consumers are really aware of that term and are capable of using it easily enough. The existence of the term in and of itself should not be a reason to conclude that the contract is fair as long as the court is not convinced that most consumers can really use it to their benefit.

In the context of Example 11, a court should consider whether the dry cleaning firm took the necessary steps to make the advantages and disadvantages of insuring clothes against loss or damage clear to all consumers. It should also consider whether insurance was made easily available to those who were willing to pay for it. It is quite possible, though, that given the small scale of the transaction, most consumers would find the transaction costs involved prohibitively high, even if the cleaning firm took all necessary steps to lower these costs. If this were the case, the reviewing court could assume that insurance was not a feasible option and consider the contract's fairness under that assumption.

#### CONCLUSION

Unlike previous literature, this Article did not focus on the asymmetric information between the supplier and consumers created by boilerplate language that includes harsh terms. We focused on other benefits the supplier can derive from the transaction costs that boilerplate language and standard-form contracts create, most of which have been ignored by courts and legal writers. The main goal of this Article was to identify these hidden roles of boilerplate language and the artificial imposition of transaction costs and to focus attention on them.

As the Article has demonstrated, transaction costs generated through boilerplate language or in other artificial means could have different impacts on different types of consumers, enabling, *inter alia*, the screening out of unwanted consumers, price discrimination, cartel stabilization, and the studying of consumer preferences. On other occasions, the transaction costs are imposed in order to hide benefits granted to certain consumers. On yet other occasions the transaction costs are self-imposed by the supplier in order to signal to buyers or competitors that negotiation of the contract would be very costly.

There are also cases in which boilerplate language and the artificial imposition of transaction costs do create asymmetry of information between the supplier and its consumers, as in the classic discussions of boilerplate language, but the asymmetry is used as a cartel-facilitating tool, an anticompetitive signaling device, or a tool for creating the appearance of a fair contract, rather than to merely extract surplus from uninformed consumers.

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109. See *supra* note 72.

Some of the uses of boilerplate language and transaction costs that we identify are desirable (such as signaling not to negotiate a warranty) and some are not (such as facilitating ethnic discrimination, artificially complicating the contract in order to harm competition, and creating a false appearance of a fair contract). Most of the uses, however, are in between these two polarities, and their desirability depends on the particular circumstances of the case (such as some cases of screening out small buyers, some cases of price discrimination, and some cases of collecting information about consumer preferences).

We identified two practices that especially raise policy concerns. The first is the practice of artificially complicating the transaction, and the second is the practice of hiding benefits in the boilerplate. These concerns are new to the legal scholarship and case law and should be addressed by courts in appropriate cases. Part V of the Article approached the question of whether and when the use of beneficial boilerplate terms is desirable from a social perspective, and if not, we ask how the law should discourage them. When beneficial boilerplate terms are adopted in oligopolistic markets, legal intervention could be required in order to cope with the anticompetitive effects of such a practice in such a setting, subject to a balancing examination between the degree of potential harm to competition and possible welfare-enhancing benefits of the practice in a particular case. We show how current antitrust and contract law doctrines could be applied in order to cope with these policy concerns. Regardless of the structure of the market, courts should also intervene when there is a special relationship between the supplier and the harmed customer raising a valid claim under contract law. Also, when a supplier tries to create the illusion of a fair contract by using a beneficial boilerplate term that is not really enjoyed by most consumers, courts should acknowledge the inaccessibility of the hidden benefit rather than judging the contract as if all consumers could enjoy the benefits.

It is hard to verify whether suppliers are really trying to achieve most or all of the different goals discussed in this Article. It is also hard to know whether suppliers are even aware of the different uses of boilerplate language and of artificial transaction costs imposed upon consumers. But even if suppliers are completely ignorant of these goals and uses, it is still important to be aware of the *consequences*, even if unintended, of using boilerplate language. The aim of this Article was to illuminate these consequences.

