Comment on “When and Why Individuals Obey Form-Adhesive Contracts: Experimental Evidence of Consent, Compliance, Promise and Performance”

Shyam Sunder

Abstract

The assumption that “form-adhesive” contracts offered by organizations to their customers, without opportunity to negotiate the terms, are inherently exploitative does not have theoretical or empirical support. Ruling such contracts out will raise the cost of operating organizations of non-trivial size to the point of eliminating them.

Keywords: Form-adhesive contracts, organizations, power, exploitation

JEL Codes: J41, K12, L14, M55

The title of the paper promises a great deal. In these few minutes, I shall try to comment on alternative ways of looking at form-adhesive contracts, and assess the answers provided to the questions posed.

The idea of form-adhesive contracts and their role in society is central to this paper and to the larger body of work of which this paper is a part.¹ In contradistinction to freely negotiated bilateral commitments, Eigen (2011, p. 2) defines form-adhesive contracts to be “drafted by organizations, intended to be signed by multiple signers, and offered without any opportunity to negotiate over the terms.” Such contracts are seen as instruments to “exploit the law to replicate existing power advantages they [organizations] hold over individuals with whom they deal—employees, customers, and care and service recipients […] because contracts lend the impression of legal constraints, and by implication, invoke the State as the background sanctioning body of the contents of the contract, lending the impression of legitimacy and authority of the drafters” (pp. 2f.).

These ideas appear to be based on certain assumptions about the relationship between the form of bargaining and negotiations on one hand, and outcomes on the other. Does a take-it-or-leave-it deal favor the seller who sets the price, or the buyer who decides on the deal? What is the information structure of such games? What are the other social or legal consequences of such transactional arrangements, and to what degree do they justify the perspective outlined in the preceding paragraph?

¹ Yale University, shyam.sunder@yale.edu. These comments were written in reaction to the companion paper, also by Eigen and available at http://ssrn.com/abstract=1640245 (accessed August 11, 2011), which had been presented at the conference.

¹ See also Eigen (2012).
Most retail stores in U.S. operate as posted-price auctions (in jargon of economics). Automobile, residential housing, and flea markets have active bilateral bargaining, stock markets have multilateral version of active bilateral bargaining (called double auction). Estate furnishings, art, used farm equipment, and some residential housing get sold through English auctions where buyers competitively set the price.

If it were true that negotiations favor the active party (who sets the terms of contract, pricing etc.) over the passive party (who decides to take it, or to leave it), we should expect prices in posted price markets to favor the party who does the posting. In actual results from prior research, prices in steady state, depend on the degree of competition prevailing on the respective sides of the market. The direction of convergence to the neighborhood of equilibrium prices depends not only on the negotiating mechanism but also the relative size of consumer and producer surpluses.

Most people sign apartment leases full of pages of fine print, just as authors sign copyright transfer forms to publishers. These forms often include articles that may be quite unreasonable. A publisher recently asked me to sign a form that included the author indemnifying the publisher against the cost of any legal defense and consequences of libel, defamation, etc. as a result of publishing my article. Since my net worth could not pay for more than a few hours of their lawyers’ labor, I asked the publisher to have the lawyer review my article to suggest alterations to eliminate the risk of law suits. I never heard back from the publisher; they went ahead and published the article.

I suppose the author has in mind the situations in which most renters or authors do not take the time to read the provisions included in the printed form. Even if they do, it is too cumbersome to ask for changes. Surely, the clerk will say “I did not write this form.” And there is no clerk to talk to when we click the “I agree” box on a long and unread user agreement for software of almost any kind.

But this is, essentially, an economic choice in which one trades-off some immediate time and convenience against the risk of (apparently unlikely, but in reality unknown) chance of signing an unreasonable or unacceptable provision included in the contract. Before the outcome of this process is labeled exploitative, it seems two question need to be addressed: Are there any corresponding advantages to the passive party in such “form-adhesive” contracts? What is the effect of such contracts on the division of surplus between the two parties (as compared to alternative forms)?

The lease and copyright transfer forms, laws and services of a city, and department store prices may appear rigid and rigged against the consumer. Yet, as Charles M. Tiebout (1956) suggested in his “A Pure Theory of Local Expenditures” even localities compete and people move from one city to another. Form-adhesive contracts can be seen as a way for the sellers to show their wares, so to speak, to allow their customers to make choice among the offerings. The fact that most customers do not look at various alternative is akin to most people do not visit different grocery stores to buy apples and oranges. It is a matter of cost and time. Also, any negotiating disadvantage of the customer is associated with an information advantage: form-adhesive contract require the contract writer to share a lot of information but require the other party to reveal little or nothing.
The idea of “form-adhesive” contract seems to assume that the costs of bargaining, negotiation, and search do not exist, or are trivial. Imagine the cost to the landlords, and ultimately the renters, if the terms of each apartment lease were to be individually negotiated. A lawyer may have to be present not only to negotiate each deal, but also to advise whether the landlord should send a plumber to apartment number 1239 when a midnight call about a bathroom leak is received. Without form-adhesive contract, every renter could have a unique set of terms. National laws also are “form-adhesive”, probably because the cost of individually negotiating the tax laws with each citizen would not only be prohibitive, but will be ultimately unfair.

In addition to language of exploitation and sociology, economics offers another way of looking at “form-adhesive” contracts that may be useful. The present paper (and the literature of which it is a part) chooses the former. It tries to identify if active choice, and prompting by moral or social suggestions has an effect on compliance. While the question addressed in the paper is interesting in itself, my preference would have been to first ask: what difference do “form-adhesive” contracts make to welfare of the participants? The setup of the paper seems to assume an answer to that question. If the question is already settled, an appropriate reference should be added.

The experiment itself is carefully designed. There is literature on participative budgeting beginning 1960s on the impact of participation on compliance with budgets in organizations. This work seems highly relevant to, and consistent with the findings of, the paper. Participation usually brings not only greater acceptance but also greater comprehension of the terms. Whether this increase in comprehension will justify Microsoft negotiating contract for the use of Windows operating system with each of us is not addressed.

When such questions are addressed, I would not be surprised to find that “form-adhesive” contracts get used mostly when doing so enhances social welfare. The research could also help us identify situations where it is not true, and thus make a case for reform in specific circumstances.

References