ContractsProf Blog

Monday, February 17, 2014

GLOBAL K: Empirically Speaking

By Michael P. Malloy

Genuine, rigorous empirical analysis is always welcome in Contracts scholarship. It not only gives context to abstract principles, but also reminds us what is at stake. One of my favorite examples of empirical analysis in Contracts is Peter L. Fitzgerald's 2008 article *The International Contracting Practices Survey Project: An Empirical Study of the Value and Utility of the United Nations Convention on the International Sale of Goods (CISG) and the UNIDROIT Principles of International Commercial Contracts to Practitioners, Jurists, and Legal Academics in the United States*. This is where many of us learned – or had our suspicions confirmed – that many practitioners and most judges were ignorant of the UN Convention on Contracts for the International Sale of Goods. In a broad 2006-2007 survey sampling practitioners, law professors, and state and federal judges in California, Florida, Hawaii, Montana, and New York, Professor Fitzgerald noted that U.S. practitioners reported relatively low levels of familiarity with the CISG (30 percent of reporting practitioners). Even more alarming was his finding that 82 percent of reporting judges indicated that they were "not at all familiar" with the CISG.

A fresh and thought-provoking example of empirical analysis has recently appeared, and every Contracts scholar and practitioner should be aware of it. *Dysfunctional Contracts and the Laws and Practices That Enable Them: An Empirical Analysis* features two empirical studies and an experiment that seem to have significant policy implications for contract law and consumer protection policy as applied to real estate transactions. These were designed and conducted by Professor Debra Pogrund Stark of John Marshall Law School, Dr. Jessica M. Choplin, a psychology professor at DePaul University, and Eileen Linnabery, a graduate student in industrial/organizational psychology at DePaul University.

The authors reviewed form purchase agreements used by condominium developers in Chicago, Illinois from 2003-2008, and found that 79 percent of the agreements contained what the authors considered "highly unfair, one-sided remedies clauses." The form agreements provided that in the event of seller's breach, buyer's sole remedy was the return of the earnest money deposit., which did not cover any of the losses that would normally be the basis for relief in a breach of contract action, whether expectation damages, consequential damages, or reliance damages, or specific performance where that might have otherwise been warranted. In contrast, the contracts provided that in the event of buyer's breach, seller could retain buyer's deposit, typically between 5 and 10 percent of the purchase price. A survey of over one hundred attorneys in Illinois conducted by Professor Stark appears to corroborate the view that there were "serious problems with remedies clauses" in agreements like those in the Condo Contracts Study. The authors argue that these "dysfunctional contracts," where the relatively more sophisticated party could deliberately default and terminate the contract with virtually no harm to itself, rendered the contracts "no true binding agreement from that party," in effect unconscionable or illusory. It appears, however, that only a few Florida cases like Blue Lakes Apts., Ltd. v. George Gowing, Inc. and Port Largo Club, Inc. v. Warren have ruled such contracts to be illusory, whereas most state courts looking at the issue have so

far rejected that argument.

One might wonder about the extent to which courts are influenced by the assumption that these were bargained-for terms, and to that extent should escape such attacks. The authors have something to say about this. They ran a "Remedies Experiment" to gauge non-lawyer awareness of the imbalance of such remedy clauses. They found what they considered "a widespread failure of the participants to understand the impact of this type of clause on their rights after a breach." This empirical insight might put into question the assumption in many unconscionability cases that buyer understands the clear wording of such clauses and in fact bargained for the result. If this is simply not true – and if the contrary assumption is being relied upon strategically by professional sellers – then perhaps the traditional unconscionability test needs to be rebooted in the real estate development context.

The authors conclude that buyers need greater protection, and they advocate four legal reforms in this regard. First, they recommend revision of unauthorized practice of law rules to require attorney review and approval of home purchase contracts, specifically by attorneys specially trained and licensed for this type of representation. Second, they recommend legislation to prohibit remedies clauses that limit buyer remedies to return of deposit and that create safe harbor rules based on mutuality of remedy and true bargaining in the home purchase contract. Third, they argue for the replacement of the substantive unconscionability test for limitation-of-remedies clauses with a "reasonable limitation of remedy" test in the home purchase context. Finally, they recommend legislation mandating award of attorneys' fees to the prevailing party in litigation involving enforcement of rights in the context of home purchase agreements.

Regardless of one's assessment of the desirability of these suggested reforms – or of their practical and political possibility – the analysis in *Dysfunctional Contracts* is rigorous, provocative, and compelling. This is a "must read" piece of Contracts scholarship.

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http://lawprofessors.typepad.com/contractsprof_blog/2014/02/global-k-empirically-speaking.html