Consumer Finance Monitor (Season 8, Episode 14): How to Use the Restatement of Consumer Contracts: A Guide for Judges

Speakers: Alan Kaplinsky and Greg Klass

Alan Kaplinsky:

Welcome to the award-winning Consumer Finance Monitor podcast, where we explore important new developments in the world of consumer financial services and what they mean for your business, your customers, and the industry. This is a weekly show brought to you by the Consumer Financial Services Group at the Ballard Spahr Law Firm. I'm your host, Alan Kaplinsky, the former practice group leader for 25 years, and now senior counsel of the Consumer Financial Services Group at Ballard Spahr, and I'll be moderating today's program. For those of you who want even more information, either about the topic that we're going to be discussing today or any other topic and the area of consumer finance law. Don't forget about our blog, which also goes by the name of Consumer Finance Monitor. We've hosted our blog since July 2011 at the very same time that the CFPB became operational. So there's a lot of relevant industry content there.

We also regularly host webinars on subjects of interest to those in the industry. So to subscribe to our blog or to get on the list for our webinars, you can visit us at Ballardspahr.com. And if you like our podcast, please let us know about it. You can leave us a review on Apple Podcasts, YouTube, Spotify, or wherever you obtain your podcasts. Also, please let us know if you have any ideas for other topics that we should consider covering on our show or speakers that we should consider inviting as guests on our show. Today, I want to introduce our speaker first and then I'm going to provide a little bit of background and then we're going to jump into the show. So I'm very pleased to have as our guest today, professor Gregory Klass.

Gregory received his BA from Carleton College, a PhD in philosophy from the graduate faculty of The New School for Social Research and his JD from Yale Law School. After graduating from law school, Professor Klass clerked for Guido Calabresi on the Second Circuit Court of Appeals. Before coming to Georgetown, he served as an assistant solicitor general in the office of the New York State Attorney General. Professor Klass's Scholarship focuses on contract law, the law of deception and legal theory. He has written on topics such as contract interpretation, consumer contracts, fraud liability between contracting parties, false advertising law and contract theory. A very warm welcome to our show, Gregory. Delighted to have you.

Greg Klass:

Thanks so much, Alan.

Alan Kaplinsky:

So let me provide a little bit of background. We're going to deal with a topic that we've addressed before on our podcast show and we have addressed on our blog over a period of years because what I'm about to mention, namely the restatement of the law consumer contracts was a multi-year project of the American Law Institute, or as we will more frequently refer to it ALI. So let me just mention the other podcasts that we've done. There are two of them. We first did a podcast show on May 16th, 2022, and it was an introduction to the Restatement of Consumer Contracts. And my special guest for that show was Steve Weiss, an ALI Council member, and the second podcast show we did on November 10th, 2022 and it was called Electronic Contracting, the New Restatement of Consumer Contracts and Other Emerging Regulatory and Litigation Issues. And our guest for that was one of the co-reporters for the Restatement of Consumer Contracts, Florencia Marotta-Wurgler, a professor at New York University Law School.

Today with Professor Klass, we're going to be talking about a new article that he has co-authored with Ian Ayres, a professor at Yale Law School, and it's called How to Use the New Restatement of Consumer Contracts, A Guide for Judges. Sort of a, you can think of it as a roadmap that judges ought to use or a blueprint on when to consider applying the Restatement of

Consumer Contracts. So got a lot of questions for you Greg, and let's jump into it. Let's start with a very basic question that will lay the foundation and will build from that point upwards, and that is, what's a restatement of law?

Greg Klass:

That's a great question. I teach first year contracts in the fall, so brand new law students, and the first thing, when you teach contracts, you talk about the restatement and the first thing you have to do with your students is say, "What is this weird creature that's a restatement?" As a lot of your listeners probably already know, the general law of contracts in the United States doesn't exist in any statute. It's the common law of contracts, it's judge-created law. That means it exists in thousands, tens of thousands of cases where judges decide individual cases and then slowly they announce rules and those rules evolve over time and it can be difficult to find that law in so many cases. Starting in the 1920s, the American Law Institute, which is not a governmental body, it's a body of learned individuals, judges, lawyers, academics, began the project of the restatements, which essentially was collecting all of that case law, synthesizing it, distilling it down to a few basic rules.

The key here is that a restatement is not the law, it's a restatement of that common law. The restatement doesn't have its own legal authority, but it does have tremendous persuasive authority with courts. So the restatement of contract law, the restatement of torts, the restatement of property, these, and I mean there are many restatements by now, these have a huge persuasive authority with courts, but courts often follow them, but they don't always.

Alan Kaplinsky:

So let's now talk specifically about the Restatement of Consumer Contracts. And it has a very long history or I would say fairly long for a restatement of this sort, which is a, it's not like the restatement of contracts itself, which really covers a lot, almost the entire area of common law contracts. This is a niche area that is being covered by a special restatement. A very controversial project, I will say, I know that because I was on the board of advisors for the restatement and there were a lot of people who thought, including myself, that this was more appropriate for an ALI project dealing with principles rather than a restatement of the common law.

Because at least in a lot of the earlier drafts, I viewed the restatement that they had put together as being more aspirational than it was a reflection of the common law. So maybe if you would, Greg, fill in a little bit more about the history and scope of the restatement, and maybe in particular talk about how does it fit with the restatement second of contracts? Is it purely supplemental or are there areas where there are conflicts between the two?

Greg Klass:

So let me just start with a few basics. The project has taken about 10 years and finished up just last year in 2024 when the membership of the American Law Institute voted to adopt the 10 provisions in the current restatement. Three reporters, so the reporters of a restatement are essentially the authors, they organize the whole project, they're responsible for the final language. The three reporters that the American Law Institute appointed were Oren Bar-Gill, Omri Ben-Shahar, and Florencia Marotta-Wurgler, who you've had on your show. This was an interesting choice I thought so at the time, and I think they would agree it was an interesting choice. None of those are really doctrinal scholars. They're all law professors very often, most often I think the reporter on a restatement is a law professor, but Oren and Omri are both trained economists. Florencia is an empirical scholar. She's done some really fantastic work using big data to understand how consumers, whether consumers read standard terms in their contracts, what those standard terms are.

But none of them had a lot of scholarship on actually working with the case law. So that was an interesting question and I think, Alan, it goes to your questions early in the project, where it was more aspirational and less based in the case law. My sense is that was, and in fact I've spoken to the reporters and they suggested, well, if the ALI picked us, I guess they wanted us to do what we do in our scholarship, which is, I think a little bit more aspirationally. And I think the arc of the restatement, the arc of the project went from something that was a little bit more aspirational to something a little bit more grounded in the case law. Although I don't want to overstate that right from the very beginning, Florencia in particular did a lot of work digesting and reading and looking empirically at what the cases were saying.

So that's the history of the project with respect to how it fits with the second restatement. So second restatement came out in the early '80s. The first restatement was in the '30s of contract law, was in the '30s. Second restatement comes out in the '80s, there had been a lot of changes in the law, changes in thinking about contract law. So that led to the production of a second restatement, that has over 300 separate provisions. As you said, Alan, it covers all of contract law and is very general in scope. So the rules in the second restatement apply to all contracts. The restatement of consumer contract law has a much more narrow scope. It really focuses just on the law of contracts as it applies to consumer contracts, contracts that firms draft and give to consumers on a take-it-or-leave-it basis, so-called contracts of adhesion.

So that's a very special type of contract, and as a result, so you can see how specialized it is, it's much shorter, whereas the second restatement has over 350 separate sections. This restatement has 10. So it's a shorter work, much more focused. The reporters say that it's consistent. I think it is largely consistent with the second restatement of contracts, but it provides much more specialized or targeted rule. So I would say it supplements, it doesn't displace the second restatement, but it supplements, except there are areas we'll talk about it maybe the parole evidence rule and elsewhere. Where I would suggest it actually is, there's a tension with the second restatement, a good tension. I think it departs from the second restatement in ways that are appropriate for consumer contracts. Have I answered everything?

Alan Kaplinsky:

Yeah, you have. What I'm curious about, we've had a few years go by since it was officially adopted by ALI. Oh, let me add one thing to the mix. When I was first appointed to the board of advisors, I thought that I would actually have a vote on this restatement, and that's not true. There are a lot of people on the board of advisors. In fact, there are different levels. There are people who are on an official board of advisors and there's even another group of people, I forgot what they're called, but they also frequently attend all the meetings and they talk a lot and they consume more time than the reporters consume. And it's usually a lot of critical comments, and a lot of the people on the board are foreigners surprisingly. For this particular restatement, I remember there was somebody from Germany, there were a few other foreign countries represented who talked about the law in their country, which I didn't really care to hear very much because it was quite boring I thought, and not largely relevant.

There were judges, there was a Ninth Circuit judge on the board of advisors. So much to my surprise, at the end of the project, the only people who count really in terms of officially approving the restatement are the ALI's council. There is a group where people are appointed to the council, the reporters of course, and then it goes to a vote of the members of ALI., and the first time it went to a vote of the members, it didn't make it through. It was very controversial. Then a few couple of years later, there was a pause because of the pandemic and then it finally made it through. But a lot of changes were made to the restatement before it made it through.

Greg Klass:

I attended that meeting when it didn't make it through and that was a raucous meeting. And I had never been to an ALI meeting before, I'm not a member, but I showed up. I don't remember whether I had to sneak in or I could just walk in, and I was surprised. It's a giant room when the full membership is there. And obviously a lot of people don't have expertise in the area. I mean, most people, you can't be an expert in everything in law, and yet it's the entire membership that votes to approve or reject the restatement. And so this just is not our topic, but I think the ALI processes are really interesting, how these things come to be and how they get churned out. I did forget to address one of the things you said earlier, Alan, and that's more appropriate for a principles project.

I agree. This was when the project started. I said, "Why are we doing a restatement of consumer contract law?" First off, a lot of it does not exist in the common law. Consumer contracts are regulated by all sorts of other laws, from very general laws like the Federal Trade Act or state Unfair Deceptive Act and Practices statutes to much more targeted laws that address very specific types of consumer contracts like credit cards or consumer credit or door-to-door sales or whatever. But those are all statutes. And so I wondered, it seemed to me a principles project to explain to the listeners is targets not, it doesn't say what the rules are. It says what principles judges and legislators should think about in making rules for this area of law.

And I agree with you and I still think so. Although I like the product, I like a lot of aspects of what came out of this, particularly because where do most consumer contracts exist today? Online, and we haven't had that much experience with

online contracting. So when you think about the common law, the way judges are responding to online contracts, it's really less than 20 years of common law addressing this. And you might say, well, we should have given the common law a little bit more time to develop in its own way to think about how to address these contracts rather than jumping in with a restatement of a law that isn't yet fully formed.

Alan Kaplinsky:

Well, that's a nice segue into my next question, Greg. And that is have the courts been citing it? Have they been relying on it? Has it had any persuasive impact?

Greg Klass:

Yeah, I just went this morning onto Westlaw and did a quick search. I wouldn't say I was not the most complete search I might've done, but 18 cases have cited that I found, cited the restatement, many of them in its draft form. So very often courts cite a restatement before it's been approved by the membership. What was interesting to me, so 18 is not a lot, but it was only adopted less than a year ago, so not, maybe it'll have more impact as it goes. What was interesting to me is that most of those cases, 14 of the citations were to the provisions that talk about how consumer contracts get formed, that it's okay to present a consumer contract online. And that clicking, I agree, is enough and some citations to the fact that it's enough even though consumers don't read. So those are what I would call formation rules.

And then even more, the five of the cases cited to that, nine of them cited to the rules for modification, which provides that actual a click I agree, is not required, that it's enough if consumers are given reasonable notice that the contract is being modified. I'm sure all of your listeners are familiar with this because you get an email from some service you've subscribed to saying, we've changed our terms of service and if you say nothing, the change will go to into effect in say 30 days. And in effect, you have to opt out of the modification rather than opt into it. So many of the cases, half of them were citing to that provision. What the cases have not been citing to yet are the ones Ian and I think are more interesting, and those are the more substantive checks on consumer contracts. So we hope that this article helps to correct for that because those are the parts of the restatement that we think are radical and that may affect a greater change in the common law of consumer contracts.

Alan Kaplinsky:

Right. Okay. Well, now let's get into the details of the new restatement and the issues that you address in your article. How would you describe, first of all, Greg, the overall approach of the new restatement?

Greg Klass:

I don't think the reporters have stuck with this. In fact, I know they haven't. They received some pushback, but I think this way of describing it's still accurate. In an earlier draft, the reporters described the project as a grand bargain. And the grand bargain was that firms get to draft the terms of consumer contracts they want, the firm drafts the contract and they to decide on the terms, the consumers don't decide, and the consumer consent is relatively thin. We know consumers don't read. We know that consumers always click on I agree. So we're not going to insist on a more robust form of consumer consent. And that's the one side of the bargain. The other side of the bargain is that courts will look into the substantive fairness of the terms in the contract. So because consumers don't read, we need courts after the fact looking at those terms and deciding whether they're fair, reasonable, two-one sided in favor of the term.

So that's what the reporters called the Grand Bargain. In that earlier draft, Mel Eisenberg sent a letter in that was quite critical of that language and then it disappeared. But I just think that's the general approach. We're not going to try to educate consumers, so that consumers themselves will police the contract, instead we're going to rely on courts afterwards to decide whether the terms are fair or not. This is all supported by the reporters own academic work. So Florencia's work suggests that consumers never read and she has some wonderful empirical evidence to support basically what we all know, that even those of us who are lawyers just click, I have read and I agree, it's just not worth your time to read all of the terms that come in a consumer contract.

I mean, I didn't even read my home mortgage, which you might think is maybe the most significant contract as an individual I've signed. And then also the reporters themselves, their academic work suggests you can't force consumers to read. Just disclosing, more disclosure doesn't help. And now I'm thinking about Oren Bar-Gill's work, there is evidence that firms sometimes take advantage of that, and so we need some kind of a substantive check on it. So that's the basic approach, allow firms to set terms and then courts will police them for substantive fairness.

Alan Kaplinsky:

Okay. Well, you identify a number of individual provisions of rules that you should suggest that judges should pay attention to. Maybe we can take them in order. Let's start with the reasonable expectations rule in section four. What is that?

Greg Klass:

So section four, I think this is section 4D. I'm saying this from memory, it has several rules of construction, but the one that we think is most interesting and new is this reasonable expectation rule, which says that the standard terms, the terms that are in the fine print, we might say, that a standard term that consumers are unlikely to pay attention to is not enforceable if it is contrary to consumers reasonable expectations. So in other words, you can't bury something in the fine print. The drafter can't bury something in the fine print that would surprise the consumer. Now, where do those reasonable expectations come from? That might be because the firm has made other representations or that the consumer has paid attention to that are contrary to the fine print, or maybe it's just what consumers normally expect to get in a transaction of this type. And so firms can't go beyond what a consumer might reasonably expect entering into this kind of a deal.

Alan Kaplinsky:

So can you say something about how this rule got into the restatement?

Greg Klass:

Yeah. Reasonable expectations actually originated in insurance law back in the '70s. It was a famous paper in the Harvard Law Review, and the idea was that in an insurance contract that insurers couldn't put in the fine print terms that the insurer, the consumer wouldn't expect. So for example, if you're buying a homeowner's policy that if there's some kind of exclusion of coverage in the fine print, that you wouldn't expect, that you wouldn't reasonably expect, that even though it's there in the fine print, it's not going to be enforceable. It's a way of preventing insurers from bearing terms. That made its way into the second restatement in this underutilized section 211 of the second restatement, which deals with contracts of adhesion, especially consumer contracts.

It's gone up and down in the insurance contract. In the insurance context, there was a wave of courts adopting the reasonable expectation rule and then it's faded since then. The reporters cite mostly insurance cases. And I don't know that it has had broad applicability though in those years, but I think it's actually a good thing. Ian and I argue, Ian Ayres, like when I say Ian, I mean Ian Ayres. Of course Ian and I argue that this is actually a good substantive check on how firms draft the small print, that they shouldn't be permitted to bury terms that are really contrary to what a consumer would expect in the standard terms that they know, and we all know consumers never read.

Alan Kaplinsky:

So how does the court go about determining what a consumer's reasonable expectations are?

Greg Klass:

Yeah, that's a great question. Well, we don't have a lot of case law on this, and so this is where our article breaks a little bit of new ground. I think where we suggest, going back to the insurance context, you might've asked a jury to decide what would want something, it's a fact question what people reasonably expect, so you might've tossed it to the jury or something like that, who would rely on their background knowledge, and as consumers themselves. We suggest there's a whole bunch of new tools that make it relatively cheap to actually empirically test what consumer's expectations are. So this is Mechanical Turk and these

other online platforms where it's pretty cheap to get a representative panel of individuals to answer online some simple questions.

So you say, "Well, there's a transaction of this type and the advertisement for it. Say it's a subscription to a magazine or something's, here's the website where you're subscribing. Would you expect this? Or what would the terms that you would expect with regard to say renewal, would you expect the subscription to automatically renew or would you expect it to, that you would, after one year you would be asked about it?" And that's now for a couple of hundred bucks, you can run a survey like that. And it's not something that I think courts have done much or parties have done, but we think these are really powerful tools that courts at the very least should experiment with. Again, this is a new area of law. Part of what we're arguing in this article is that it is still developing and courts should be creative, but we think this sort of empirical work could be really powerful to think, to ask and determine what our consumer's actual expectations rather than just throwing it to a jury.

Alan Kaplinsky:

I've never heard of that kind of a tool before, but sounds very, very interesting.

Greg Klass:

Well, I'll just say one more thing. What's interesting is you probably know in false advertising law, Lanham Act cases, courts often use this, they're called copy tests in this context, to ask whether advertisement is actually deceptive, what beliefs it causes in the audience. Those used to be really, really expensive to run. You'd have to hire sociologists or psychologists and you'd have to get people in a room, and the internet has just made it super cheap. So we think it's worth trying out.

Alan Kaplinsky:

So let's turn now to unconscionability. That is in section six of the restatement, and it's dealt with in the Restatement of Consumer Contracts. The first has to do with procedural unconscionability. Can you explain that?

Greg Klass:

Yes. So let me say basically section six is the primary substantive check on the fairness of contracts. So if I go back to this grand bargain language, section two says that consumer, a minimal level of consent and understanding still results in a contract that the standard terms still get in. In section six, the unconscionability defense provides the rule for courts to do a check on the substantive fairness of those terms, that the primary test, you might say, another test is this reasonable expectations doctrine. But unconscionability has been around since, well, it appeared in the Uniform Commercial Code. It really became recognized in US law in its current form in the '60s. And the unconscionability, it's a defense to a contract or a contract term. And the requirements that courts have developed are you have to show two things to raise the unconscionability defense. One is that there's some substantial unfairness that is one-sided or the terms are one-sided or oppressive or otherwise unfair.

And the second is a procedural unconscionability, that there was some problem in the way the contract was formed. It doesn't have to be fraud or duress, that would be a separate defense. But then maybe there was a lack of education on one side, or there was a sales practice that was a little bit unsavory, a high pressure or something like that. And to raise the unconscionability defense, you have to show both, both substantive unconscionability and procedural unconscionability. All right, so that's all background. The Restatement of Consumer Contracts adopts that framework. This is in a way that it's completely consistent with the second restatement. Where it goes a little bit past that and following courts, it says the fact that standard terms, the fact that a term appears in the unread fine print is enough to satisfy that procedural prong.

So in other words, a plaintiff or defendant, a consumer litigant, doesn't have to show anything more than that. The term that the firm is trying to enforce, that the drafter is trying to enforce, appeared in the small print. That satisfies the procedural prong. That means that any unread terms, terms that consumers are unlikely to pay attention to, courts are licensed to look into their substantive fairness, which again goes back to this idea of the grand bargain. So that rule for procedural unconscionability is essential to making that the whole approach of the restatement work.

Alan Kaplinsky:

I thought there was a sliding scale that at least a lot of the courts have deployed, where if there was a small amount of procedural unconscionability, it required a higher substantive unconscionability, almost like a seesaw approach. If there's not much substantive unconscionability, there has to be a higher degree of procedural unconscionability. Does that not apply in the restatement? Because as you said, just about every consumer contract is going to satisfy procedural unconscionability because nobody reads it.

Greg Klass:

Yeah, that's right. And let me just, the listeners can't see this, but Alan did with his hands exactly what I do in class on the seesaw, to raise your right hand up and put your left hand down and vice versa. That more of one means you need less of the other. And that's also pretty well established in the case law right now. And so I don't have an issue with the new restatement affirming that. That's what courts have said, that if something is really procedurally problematic, then a little bit of substantive problem is enough. And maybe that's really important, if it's substantively super problematic, you might need no procedural unconscionability. I mean, that's the extreme form of the sliding scale that it may be that in some cases substantive unconscionability is enough. The worry that we express in the paper is that the notes suggest that the fact that a term appears in standard terms standing alone, that consumers are unlikely to pay attention to it, they say that that's the minimum quantum of procedural unconscionability.

In other words, it would have to be really substantively bad to satisfy the unconscionability. If you adopt this sliding scale approach, if appearing in the standard terms is a minimum quantum of procedural problem, then it would've to be really substantively problematic. And that to our mind, gets all the incentives wrong. It means that firms can go right up to the line. It's okay if it's a little bit bad, but just don't make it really, really terrible. So we suggest the sliding scale has a place, but maybe not in this respect, not in this aspect.

Alan Kaplinsky:

Let's turn now to another part of the unconscionability defense that you talk about that has to do with class actions. Can you explain that?

Greg Klass:

Sure. Maybe a lot of listeners are familiar with the way the law of arbitration has developed in consumer contracts. I'll just do a quick version of it. California courts a few decades ago started holding that arbitration clauses in consumer contracts in particular were unconscionable, non-enforceable when the arbitration clause included a waiver of class arbitration. So arbitration had to be done individually and were designed to prevent consumers from getting relief for breaches of those contracts or other wrongs. The idea is that class actions are really important in consumer contracts. The reason what the California courts were thinking is that consumer contract actions are often very low stakes. They're not worth litigating on an individual basis. And so the class action is an important tool for protecting consumer rights. And the idea was, well, if a firm designs an arbitration clause that completely gets rid of class actions, then it's insulating itself from liability.

Well, the Supreme Court in a couple of cases came in and said that holding, that California rule in Discover Bank is contrary to the Federal Arbitration Act and preempted by the Federal Arbitration Act. And so that effectively insulated those clauses, those class action waiver arbitration clauses from review under the unconscionability doctrine, not 100%, but largely, and that's the state of the law today. The Supreme Court was talking about the Federal Arbitration Act, a federal law that governs all arbitration clauses in interstate contracts, which is most contracts that we're talking about. What the new restatement does is there's a provision in the unconscionability rule that says, look, "Any term that," and I'll quote now, "unreasonably limits the consumer's ability to pursue or express a complaint or seek reasonable redress for the violation of a legal right is per se unconscionable." And there's a list of per se unconscionable rules. This is one of them, per se unconscionable terms, and this is one of them.

And what this means is that actually because of the Supreme Court rulings on the FAA, Federal Arbitration Act, that doesn't make a difference today. But if future Supreme Court ever adopts a different reading of the Federal Arbitration Act, or if

Congress ever amends the act to clarify that these cases, Concepcion and Italian Colors, those are the two most important Supreme Court cases, is a misreading, then this affirms that the courts have the common law power to hold such clauses unconscionable, when they operate to prevent consumers from bringing, for practical matters, when preventing consumers from bringing complaints.

Alan Kaplinsky:

I guess, Greg, as I think about this provision, and this was one of the things that was quite controversial, it would have, if you have what I've often referred to as a naked class action waiver that is a class action waiver that's not contained within an arbitration provision, that kind of a waiver would be deemed to be unconscionable, I believe, under the restatement. Would you agree?

Greg Klass:

I think that's absolutely right. So for those of your listeners who draft these kinds of contracts, you have to do a two-step. First, you have to move into arbitration, which gets you out of any litigation in court, and then you do the class arbitration waiver. But to the extent that anyone wants to just say no class actions without arbitration, I think this would prevent that.

Alan Kaplinsky:

And that was controversial because there's not a lot of common law out there back then, and even today that deals with that issue. It's a state law issue completely, and the law that's out there is divided. Some courts have said that's not unconscionable. And so this is an instance I think, where it's not really a restatement of the law. It's really what the reporters think the law should be.

Greg Klass:

I think that's reasonable. And the two things I would say about that is a lot of us who teach contract law thought that Concepcion in particular was poorly reasoned as, and now I'm not talking about whether the class action waiver in the arbitration clause was or was not unconscionable, but that the Supreme Court held that that was an anti-arbitration provision. It was a weird reading of the FAA. So a lot of the criticisms of those cases aren't about whether the California courts got unconscionability right or not. They were about, this is just a weird understanding of the Federal Arbitration Act. So that's one.

The second is that, and here I'm agreeing with you, courts should be able to experiment more. What Concepcion did is it put a lid on all of that experimentation itself. And now the restatement is getting ahead of courts on what's unconscionable or not. Not many people, if you read Discover Bank, which is the rule that was at issue in the Supreme Court, it was actually relatively narrow. The rule says when the clause is designed to prevent consumers from getting, there's a kind of an intent requirement in that California rule. I think that the test in section six goes beyond that, so it even gets ahead of Discover Bank. But to go back to a point, I think we both were making at the beginning, the common law needs time to evolve on these questions.

Alan Kaplinsky:

Right, right, right. Let's turn now to section seven of the restatement, and that deals with the so-called deception defense. You and Ian Ayres have written a lot about deception between contracting parties. First of all, can you describe section seven and tell us what you think about it?

Greg Klass:

Sure. And yeah, this is kind of, Ian and I started our academic work together. I mean, Ian actually was my contracts professor back when I was a student at Yale. But our first publication together shortly after I graduated was a book on promissory fraud. And both of us have thought a lot about the way that the laws of deception, whether it's tort law of negligent misrepresentation or fraud or other laws interact with contract law, which is a much broader question and we're talking about here. But what section seven does, so there's always been a misrepresentation defense in contract law. For hundreds of years

we've had a misrepresentation defense that comes from equity, and the idea is that if one party lies to the other and induces them to enter into a contract because of a lie or a misrepresentation, then the party who is deceived has a defense to the contract.

The contract is voidable by that party. They don't have to perform. It's polluted by that. The rules are more complicated than that, but that's the basic idea. The misrepresentation defense is it exists in the second restatement, requires that there be some falsehood, that there actually be a statement of fact that is false. That then actually gets a little bit modified because sometimes there's a duty to disclose. So for example, if you're selling a house that has termite damage, you might have a duty to disclose that fact, even if you don't lie about it. But that's a relatively narrow and ill-defined duty, mostly you need a false statement of fact. What we like, especially about section seven is it updates this defense to talk not about misrepresentation, but deception more generally. And rather than requiring a false statement of fact, the provision says it's a defense if the drafter or the business uses a deceptive act or practice.

That's language that is taken from the Federal Trade Act and from Unfair Deceptive Act and practices statutes. So it exists in other places in the law, but it sweeps it into the common law. And the reason why that's important is that we've got experience of sellers or businesses using practices that tend to deceive consumers. So they're deceptive, but they don't involve an express falsehood. Hiding terms in the small print would be one, but there are others, like structuring credit card fees in a way that the consumer might not really understand what they're paying for the credit card or hiding fees. Anyone who has booked a hotel on Expedia might've encountered resort fees, which you think you're getting the lowest price and then when you go to check out, suddenly this $40 fee pops up. And it's always there, there's no misrepresentation, but it's structured in a way that might be deceptive. So we think that's a good thing. There are lots of ways that consumers could be deceived without a falsehood, and it's important for courts to think about that when consumers are raising this defense.

Alan Kaplinsky:

Is reliance part of the defense? In other words, do you have to establish as a consumer that you relied on the deception?

Greg Klass:

This might be another place where the restatement is encouraging courts to develop the law. I don't know of a lot of case law that says it's not. And the second restatement, traditionally the defense requires a showing that the deceived individual relied on that misrepresentation in entering into the contract. What the rule in the restatement of consumer contract says is that actual reliance by an individual is not essential. What's important is that there's a tendency to rely. You could show that also through surveys or empirical evidence that like we've discussed, and that is, I think, important. And this goes back to the class action point. If you have to show that each individual relied on the deceptive practice or the deceptive practice caused each member of the class to enter into the contract, that would possibly defeat or probably defeat the class action. So by relying on a tendency to deceive, that opens the door to litigation that is maybe more effective.

Alan Kaplinsky:

Right, right, right. Now I want to turn to another part of the restatement that you referred to earlier that I think you also like, and that is what they have said about the parole evidence rule. Can you remind, first of all, remind our listeners of what the parole evidence rule is, and then tell them what does the new restatement say about the rule?

Greg Klass:

Sure. Happy to. This might cause a little bit of PTSD in some of your lawyer listeners from their law school days. And I think the parole evidence rule is a dark and murky area, and it causes law students a lot of pain. The basic idea though, is relatively simple. Now I'm talking about the general parole evidence rule. The basic idea is that sometimes parties memorialize the terms of their agreement in a writing, they write it down and they agree this is the key. They agree that this written document is going to be the dispositive or the final statement of what the terms of their agreement are, and that if it ever goes to litigation, the court should look first to this written document to understand what they've agreed to before it looks to any extrinsic evidence, before it looks to what's called parole evidence, before it looks to any evidence outside of. And that's a really important tool

for parties, particularly for sophisticated parties who are negotiating high-stakes contracts because they want finality and they want to get the entire agreement within a single document.

So you'll often find in high-stakes agreements or in agreements drafted by lawyers or written in a written contract, an integration clause or a merger clause, which basically says, this document is the final statement of our agreement, and it supersedes all prior agreements, et cetera, et cetera. And the parole evidence rule effectively says, when the parties agree that a writing is the final statement, then it is. And that means that parole evidence or extrinsic evidence or evidence from outside of that writing is of lesser value. It can't be used to contradict what's in the writing, or if it's a complete integration, it can't be used even to supplement what's in the writing. Complete integration is when the parties say, this is not only a final statement of our agreement, but this is our entire agreement. This is everything that we've agreed to. So that's the parole evidence rule.

There are several sections in the Restatement of Consumer Contracts that are relevant to the parole evidence rule. I don't want to go through a detailed textual analysis, but what we suggest is that when you read all these together, it basically prevents firms from integrating standard terms against their own representations. So it's effectively, the way the rules work, and these are section seven, eight, and nine taken together, is a firm cannot put in the standard terms. These standard terms are the final statement of our agreement, and they then say something contrary to those standard terms or make a promise or representation that's additional to those standard terms and later say, "Yeah, but it wasn't in the small print."

And that's a rule I think that makes a lot of intuitive sense. Why should a court treat standard terms, the fine print that they know the consumer hasn't read, including the integration clause, as a final statement of terms, and somehow trumping or preventing the enforcement of some promise that was made in a more salient, apparent, or that in a way that the consumer was more likely to notice? The rules don't come out and say that, that basically together they get rid of the parole evidence rule, but that's how we read it. And we'd be happy if judges say that firms don't have the power to integrate standard terms against their own extrinsic representations or promises.

Alan Kaplinsky:

So most of the examples that are given are about extrinsic promises or representations by a business. But what about extrinsic communications by the consumer?

Greg Klass:

Yeah, that's a really interesting question, and it just is another example of why the common law has trouble with this. It's pouring new wine into old bottles. The parole evidence rule doesn't make a distinction between the parties. Extrinsic representations are extrinsic representations no matter who makes them. We think there is an argument that maybe businesses should be able to integrate standard terms against representations by the consumer. What would that be? So you could imagine a consumer who's contracting with Amazon and before making a purchase, they send an email to Amazon customer service, which everybody knows basically doesn't exist. So you can't get in touch with anyone at Amazon. They send an email to this large corporation. They say, "I'm going to be purchasing this item on your website later today, and I expect the following warranty terms in it. If you disagree, write me back but if you accept my purchase, then you'll have agreed to these warranty terms."

And we think that's, I mean, going back to standard contract law in the second restatement or the uniform commercial code, that would be effective, right? The consumer would've made a counteroffer and then Amazon by accepting the order, would've accepted that by performance. We think that that's unreasonable, and it would be reasonable for firms to protect themselves against consumer actions of that type. You're giving standard terms, consumers can't use the traditional ways of modifying those terms. So we think there's still some place for the pool evidence rule. Again, this is a place that to my knowledge, courts haven't really weighed in on. It would be interesting to see that develop in one way or another.

Alan Kaplinsky:

Well, Greg, we have reached the end of our program today. I think we haven't covered everything in your article, but we've covered a lot. And I think the main points that you've made in your article, and I really encourage our listeners to actually read your article. It's available, I know on SSRN, is it published in a law review or is it going to be published in a law review?

Greg Klass:

Yes. In fact, I just received and returned the final edits from the students who run the Harvard Business Law Review. So it should be appearing in there in the next month or two, I would expect, but it should be easy to Google and our most recent draft is online.

Alan Kaplinsky:

Okay. Well, thank you very much, Greg, for being our guest today and helping me and helping our listeners understand much more comprehensive way the Restatement of Consumer Contracts, which I think is going to become increasingly important and will be increasingly cited by the courts because that's generally what happens with ALI restatements. So again, thank you very much.

Greg Klass:

Thank you, Alan. It was a really great conversation.

Alan Kaplinsky:

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