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## **Control or Security: A Therapeutic Approach to the Freedom of Contract**

Yuval Feldman

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## Control or Security: A Therapeutic Approach to the Freedom of Contract

Cover Page Footnote

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## CONTROL OR SECURITY: A THERAPEUTIC APPROACH TO THE FREEDOM OF CONTRACT

*Yuval Feldman*<sup>1</sup>

### ABSTRACT

The most important insight behavioral economists have brought to the economic analysis of law is that the human mind is imperfect. This general conclusion, which followed from their research, has resulted in a reduction in the importance of personal responsibility in one's life, which eventually became the basic assumption in the economic analysis of law. Legal scholars have therefore recommended that governments limit, particularly with respect to contracts, people's freedom of bargaining on contract terms. This paper examines the concept of personal control and the freedom of contract from several perspectives, arguing that the answer to the question of how much control a person should obtain upon entering into a contract cannot be resolved by the current narrow usage of psychology by behavioral economists. The author will demonstrate that the current analysis ignores many of the emotional and cognitive aspects of freedom of contract, such as process control, commitment, procedural justice and improved information processing. Drawing from quasi-normative literature on therapeutic jurisprudence and the psychology of procedural justice on one hand, and hedonic psychology and motivational psychology on the other, herein is presented a more comprehensive approach to the freedom of contract than behavioral economists have previously allowed for.

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## INTRODUCTION

In an earlier paper, *Psychological Jurisprudence as a Key for Legal Change*, this author explored the possibilities of psychology becoming a more dominant factor in the hardcore legal theory of civil law.<sup>2</sup> That paper attempted to criticize the ways in which psychology has aimed to interact with the law by comparing it with the development of sociology and economics. Except for a few cases of therapeutic jurisprudence and procedural justice, psychology has not succeeded in having any normative impact on the legal theory agenda in civil law. Daniel Kahneman, one of the founding fathers of behavioral economics, claims that psychology could never become a real alternative to economics, due to the fact that it lacks a grand theory.<sup>3</sup> *Psychological Jurisprudence as a Key for Legal Change* questioned the assumption that the law needs a grand theory, and claimed that psychology could better achieve the goals of the law by suggesting a specific paradigm for each doctrine, which would provide the policy maker with a set of psychological and therapeutic tools to supplement her other policy considerations.

This paper follows as a case study for the above-mentioned claim, which concerns the status of research on psychology and law. It explores the ability of social psychology to answer the basic normative question in contract theory: how much personal control should parties have in framing their contracts?

The “bounded rationality” approach is the line of research that is considered by behavioral economics.<sup>4</sup> Within this approach

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<sup>2</sup> Yuval Feldman, *Psychological Jurisprudence as a Key for Legal Change*, presented (poster) at the Society for the Psychological Study of Social Issues Annual Conference at the University of Minnesota (June 2000).

<sup>3</sup> Daniel Kahneman, *Two Perspectives On The Human Agent*, Address at the 6th Valdovsky Public Policy Forum at the University of California at Berkeley (May 2000).

<sup>4</sup> See Russell B. Korobkin, Thomas S. Ulen, *Law and Behavioral Science: Removing the Rationality Assumption From Law and Economics*, 88 CAL. L. REV. 1051 (2000). Nevertheless, it is important to mention that law and economics have started to treat the role of emotions not only as an error that should be “washed away” by the model, but as a good indicator of what could and should be incorporated into the model of rational choice. For the latest paper on this subject, see Eric Posner’s working paper *Law and Emotions*, Univ.

it is not surprising to find a more paternalistic perspective on parties' abilities to express their preferences and estimate the risk they are taking with their own negotiated contracts.<sup>5</sup> Naturally, behavioral economists want to reduce the role of the parties themselves in areas where it might be inefficient and harmful for the parties to engage in contracts without state protection. The claim of this paper is that behavioral economics seem to consider a part of the field of psychology that is not only small, but atypical as well. Moreover, the behavioral-economics approach in this sense does not really change any of the neoclassical normative assumptions. First, it continues to view the decision-making stage as crucial for policy making.<sup>6</sup> In the context of contract theory, in particular, this approach still views the contract as a tool for allocating risks in an optimal way. In addition, it seems that the behavioral-economics approach shares the neoclassical-economics view that the process does not matter as long as it does not impact the bottom line (expected versus experience utility). This paper attempts to show that such a perspective is especially harmful when it comes to contracts in which the impact of the process could not always be seen in the final terms of the contract but in the behavior of the parties following the act of signing the contract.

This paper focuses on two perspectives: freedom of contract as a direct source of mental well-being, and freedom of contract as a way to improve the parties' contract performance. According to the first perspective, a contracting process is most effective when each individual feels that she alone can decide how to manage her life. Situations in which many terms are mandatory, or in which courts take the freedom to partially and selectively enforce contracts, might limit such a feeling. In other words, according to this point of view, we should try to discern what level

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of Chi. Law & Econ., Olin Working Paper No. 103 (Sept. 2000), available at [http://papers.ssrn.com/paper.taf?abstract\\_id=241389](http://papers.ssrn.com/paper.taf?abstract_id=241389) (last visited Oct. 11, 2002).

<sup>5</sup> See Jeff Rachlinski, *Behavioral Economics the Uneasy Case for Paternalism*, Presented at workshop of Law, Economics and Psychology at the University of California at Berkeley (May 2002).

<sup>6</sup> See Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN. L. REV. 1551 (1998); Mark Kelman, *Behavioral Economics as Part of a Rhetorical Duet: A Response to Jolls, Sunstein, and Thaler*, 50 STAN. L. REV. 1577 (1998).

of freedom would maximize the parties' personal mental well-being.

The second perspective is that personal control over the contract might increase the chances an individual will understand and perform the contract and hence could be justified in taking classical efficiency measures. The greater the state's intervention in the freedom of contract, the fewer the chances that internal incentives to perform will be triggered. Thus, according to this perspective, we are not interested in optimizing the well-being of people in general; rather, we are interested in a mental change that will increase the parties' chances of performing a contract.

That is not to say that outcomes do not matter, they matter not only in economic terms but also in terms of a mental perspective. Courts and the legislature are not limiting individuals' freedom without reason; in most cases they do so for protective measures. Moreover, even within social psychology there are many situations in which more freedom is not always desirable to people. This second perspective forces us to think even harder about the ways in which greater freedom of contract will increase mental well-being and cooperative surplus.

Finally, this paper is not concerned with a positive analysis of the freedom of contract, but rather with a normative one. A positive description of the exact treatment of contracts by United States courts is far beyond the scope of this paper. Therefore, it cannot verify the claim of some authors that there has been a continuous decline in the freedom of contract. Nor will this paper attempt to discredit or accept any authors' claims that the importance of bargaining has actually increased in the last few years. In other words, while analyzing the meaning of doctrines such as good faith or unconscionability from a social psychological perspective, the author does not argue that their use in the trial courts has led to an unjustified outcome in deciding the dispute between contracting parties. The purpose here is to add a different perspective on the question of whether the use of these doctrines are justified from the normative perspective, given what we know of the factors explaining people's well-being.

Once the use of psychological knowledge is tailored to the normative aspect of contract policy, there nevertheless remains a major problem when trying to answer legal questions with



psychological knowledge. This problem can be defined as a jargon issue: How can one make the relevant connections between legal terms and psychological concepts? For example, what is the relationship between the legal phrase, “parties’ control” and the sense of control psychologists discuss? Moreover, even if a creative researcher is able to build an empirical connection between the two disciplines, there is still a need to refine the specific impact of the policy of any court. We cannot say, for example, that the intervention of the courts generally threatens one’s sense of control, since without courts’ intervention most contracts would not be honored. Therefore, freedom of contract can be perceived as suggesting that people need to be able to accurately predict how courts will enforce contracts.

Another view would emphasize liberty in terms of the people with whom one is free to contract with and the types of relationships one is free to contract into. Hence, even if this paper treats the various aspects of freedom as part of the same argument, the actual suggestion that derives from the argument will be more specific, according to the ideas outlined here.

This paper will start at the meta-theory level of perception of human rationality and its implications for state paternalism. Part I will present the economic legal background of the debate on the freedom of contract, and explain the rationale behind it. Part II will present the social-psychological perspective on the benefits that people experience by exercising self-control in their lives. Part III will use a critical perspective to analyze the ability of social psychology, with its multi-dimensional view of human beings, to answer a jurisprudential question. This task will be accomplished mainly by reviewing the emotional cost of bargaining over a contract, especially when people are operating without the safety net of the state. Finally, Part IV will attempt to make sense of the previous three sections by suggesting a preliminary integrative psychological model for additional factors that should be considered in the treatment of the freedom of contract by analyzing which situational constraints should be taken into account in deciding what the optimal amount of freedom is.

## I. FREEDOM OF CONTRACT AND HUMAN RATIONALITY

The concept of bounded rationality and the attack on the rationality assumptions of neo-classical economics began five decades ago,<sup>7</sup> although its impact on the law has only started to attract substantial attention in the last decade.<sup>8</sup> The main assumption of the neoclassical economic analysis of law, especially of Coase's transaction-costs approach,<sup>9</sup> is that people are best able to judge their own needs.<sup>10</sup> Based on that assumption,

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<sup>7</sup> HERBERT SIMON, *MODELS OF MAN* (John Wiley 1955). For a full discussion see OLIVER E. WILLIAMSON, *MARKETS AND HIERARCHIES: ANALYSIS AND ANTITRUST IMPLICATIONS* (Free Press 1975); OLIVER E. WILLIAMSON, *THE ECONOMIC INSTITUTIONS OF CAPITALISM* (Free Press 1985).

<sup>8</sup> For a comprehensive review of much of the research done in the area of behavioral economics and the law, see Jon D. Hanson & Douglas A. Kaysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630 (1999). For another review of the possibilities in behavioral economics research also see Donald C. Langevoort, *Behavioral Theories of Judgment and Decision Making in Legal Scholarship: A Literature Review*, 51 VAND. L. REV. 1499 (1998). For the theoretical debate of the justification to question the rational actor assumption and still stay within the boundaries of economics, see Edward L. Rubin, *Putting Rational Actors in Their Place: Economics and Phenomenology*, 51 VAND. L. REV. 1705 (1998). For a more critical assessment of the potential of behavioral economics to replace the traditional law and economics assumption of rationality, see Samuel Issacharoff, *Can There Be a Behavioral Law and Economics?*, 51 VAND. L. REV. 1729 (1998); Thomas S. Ulen, *The Growing Pains Of Behavioral Law And Economics*, 51 VAND. L. REV. 1747 (1998). See also Christine Jolls, Cass R. Sunstein & Richard Tahler, *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471 (1998); Cass R. Sunstein, *Behavioral Analysis of Law*, 64 U. CHI. L. REV. 1175 (1997).

<sup>9</sup> See Glenn W. Harrison & Michael McKee, *Experimental Evaluation of the Coase Theorem*, 28 J.L. & ECON. 653 (1985).

<sup>10</sup> See, e.g., Oliver E. Williamson, *Assessing Contract*, 1 J.L. ECON. & ORG. 177 (1985); Richard Craswell, *Efficiency and Rational Bargaining in Contractual Settings*, 15 HARV. J.L. & PUB. POL'Y 805 (1992) (recognizing some variations in human behavior, and attempting to see the rationality assumption as the best explanation for the theory of contracts). For more information in that skeptic's tradition, see Ian R. Macneil, *Economic Analysis of Contractual Relations: Its Shortfalls and the Need for a "Rich Classificatory Apparatus,"* 75 NW. U. L. REV. 1018 (1981). For another classical analysis, which attempts to understand contract relations through assumption of profit maximization motivation, see Douglas G. Baird, *Self-Interest and Cooperation in Long-Term Contracts*, 19 J. LEGAL STUD. 583 (1990).

Law and Economics scholars argue for greater freedom so that people can engage more easily in transactions and bargain to gain the legal interest they most value. The essence of this approach is that neither the court nor the legislator can accurately estimate what individuals' preferences are. Therefore, the role of the state is to reduce transaction costs and allow people more flexibility in bargaining.

As might be expected, in the context of contracts, economists have been the most vocal opponents of cases in which courts have decided that the parties' interests could not compel the courts to enforce contracts. From an economic point of view, court intervention in an agreed-upon contract between two adults is inefficient.<sup>11</sup> Nevertheless, it is important to mention that even from the perspective of efficiency, some Law and Economics scholars have argued that court intervention could promote efficiency for the parties themselves.<sup>12</sup>

Psychology has been perceived as offering a contrary perspective; in fact, most interactions of law and psychology in civil contexts have been focused on limited personal control.<sup>13</sup> It is therefore not surprising that the main contribution of psychology to legal policy has been the reduction of personal responsibility and the promotion of paternalism, as evidenced by the followings quotes by three leading legal scholars in the field. Cass Sunstein writes:

[P]rivate preferences are sometimes based on inadequate information, a large category that

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<sup>11</sup> The seminal paper on this issue is by Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763 (1983). For a specific critique on the refusal of courts to enforce damages, see Alan Schwartz, *The Myth that Promises Prefer Supracompensatory Remedies: An Analysis of Contracting for Damage Measures*, 100 YALE L.J. 369 (1990).

<sup>12</sup> Paul Burrows, *Patronizing Paternalism*, 45 OXFORD ECON. PAPERS 542 (1993) (quoted by Zamir, *infra* note 16).

<sup>13</sup> One of the main forms of scholarship in this tradition involves an emphasis on ways in which individuals' rationality could be intentionally manipulated by interested parties, though some of the biases discussed in those papers are based on people's false beliefs which precede this interaction. See, e.g., Edward J. McCaffery, et al., *Framing the Jury: Cognitive Perspectives on Pain and Suffering Awards*, 81 VA. L. REV. 1341 (1995); Roger G. Noll & James E. Krier, *Some Implications of Cognitive Psychology for Risk Regulation*, 19 J. LEGAL STUD. 747 (1990).

includes cognitive distortions in dealing with low-probability events, a subject on which there is growing data. When a decision is based on imperfect information, government may either provide the relevant information or under some circumstances ban the decision altogether.<sup>14</sup>

Richard H. Fallon, Jr. adds:

[V]irtually no one consistently maintains that respect for ascriptive autonomy precludes some version of "soft" paternalism, which permits at least temporary, coercive intervention to ensure that a person's decision to act in a self-destructive way is informed and rational.<sup>15</sup>

In addition, to Eyal Zamir, "Given the abundant empirical data on the bounded rationality of adults of ordinary intelligence, efficient paternalism should not be restricted to special groups such as minors or the mentally disabled."<sup>16</sup>

The effort to make more realistic assumptions about life, as some scholars put it, has led to legal scholarship in Law and Economics that takes a more paternalistic approach than economics originally intended. Today, behavioral economics is threatening these simplistic economic assumptions.<sup>17</sup> The collaboration of law and behavioral economics could be criticized from a different perspective, i.e., personal autonomy. Behavioral economics in its current form focuses mainly on information processing as the major consideration of the law when taking into account people's rights.<sup>18</sup> This perspective leads researchers to areas where psychology has never gone before. A few years ago, psychology had never been applied to disciplines such as contracts

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<sup>14</sup> Cass R. Sunstein, *Legal Interference with Private Preferences*, 53 U. CHI. L. REV. 1129 (1986).

<sup>15</sup> Richard H. Fallon, Jr., *Two Senses of Autonomy*, 46 STAN. L. REV. 875, 900 (1994) (internal citations omitted).

<sup>16</sup> Eyal Zamir, *The Efficiency Of Paternalism*, 84 VA. L. REV. 229, 285 (1998).

<sup>17</sup> One of the first papers to adopt this position is Thomas S. Ulen, *Cognitive Imperfections and the Economic Analysis of the Law*, 12 HAMLINE L. REV. 385 (1989).

<sup>18</sup> See Pauline Kim, *Bargaining With Imperfect Information: A Study of Worker Perceptions of Legal Protection in an At-Will World*, 83 CORNELL L. REV. 105 (1997).

or torts, and now, due to the efforts of lawyers and behavioral economists, it is a key player in cutting-edge theoretical legal writing. However, the emphasis on bounded information processing limits the scope of the discussion to the decision-making stage.<sup>19</sup> Specifically, when considering contract theory, the effort of the researchers is focused on the “content” outcome of the contracting process, and not on the impact of the contract on people’s emotions, or on their basic motivations. People’s contractual behavior, which is apparently much more important from a legal perspective, is left almost untouched.

Professor Eisenberg’s paper, *The Limits of Cognition and the Limits of Contracts*,<sup>20</sup> and Professor Zamir’s paper, *The Efficiency of Paternalism*,<sup>21</sup> are only the natural continuation of the “content” outcome approach. Eisenberg attempts to show that people’s cognitive limitations could be seen as a justification for courts not to enforce specific kinds of contracts and terms in situations where people’s ability to predict is especially limited.<sup>22</sup> Although Eisenberg does not deal with the normative question of paternalism, and still emphasizes that courts should mainly try to understand the parties’ real interests,<sup>23</sup> it could still be seen as recognizing the limits of people to serve as rational decision makers. Any positive argument about a potential *unintentional* gap between the explicit actions and true interest could be later used for a normative underestimation of people’s autonomy. It also seems to be a straightforward assumption that the court will engage in some reevaluation of the individual’s true intention, signaling to people that their control over the contract is contingent upon the court’s evaluation of their cognitive process when they originally entered the contract.

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<sup>19</sup> But see Eric Posner, *supra* note 4 (taking the knowledge of psychology to areas beyond the decision-making process).

<sup>20</sup> Melvin A. Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211 (1995) (attempting to draw an underlying theory of contract theory which takes into account human limits of calculating risk as a source for limiting freedom of bargaining and phrasing individualistic terms in several kinds of contracts).

<sup>21</sup> See Zamir, *supra* note 16.

<sup>22</sup> See Eisenberg, *supra* note 20, at 212-13.

<sup>23</sup> See Eisenberg, *supra* note 20, at 258-59.

Professor Zamir is much more direct in his call for paternalism in contracts. According to Zamir, the body of research on cognitive biases, which was mainly introduced by Kahneman and Tversky,<sup>24</sup> could lead to a situation in which paternalism will be efficient, even according to classical measures of efficiency.<sup>25</sup> The limits of cognition are therefore presented as providing legal policy makers with justification for the limiting personal freedom in contract policy.<sup>26</sup>

It is not the intention of the author to suggest that the perspectives presented by Eisenberg or Zamir are mistaken. The findings on people's limited cognition are strong enough to become a basis for their arguments. Nevertheless, it presents to the legal scholarship a very one-sided picture of the full psychological view of human choice. This author's claim is that even if one accepts the position of economic scholars that the maximization of wealth is the major rationale behind legal policy, one must not necessarily accept that every flaw in judgment should be automatically translated into limitations on personal responsibility. Such a conclusion could be reached only if the legislature and the individual were seen as competing for optimal results. When greater importance is placed on profit maximization, and cognitive flow is involved in estimating risk, the state is justified in making a policy change in order to protect the parties to the contract from themselves. However, this is not the case if we take into account both experience and expected utility.

In an influential paper, Kahneman explores whether the field of economics is capable of reevaluating the concept of experience utility originally launched by Bentham.<sup>27</sup> It seems that in the context of the proposed bounded rationality approach to contract law, the importance of measuring well-being should not be limited to the initial stage of entering a contract, but should apply to the entire contracting process. If the field of psychology

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<sup>24</sup> Daniel Kahneman & Amos Tversky, *Choices, Values, and Frames*, 39 AM. PSYCHOL. 341 (1984).

<sup>25</sup> See Zamir, *supra* note 16, at 237.

<sup>26</sup> *Id.*

<sup>27</sup> Daniel Kahneman et al., *Back to Bentham? Explorations of Experienced Utility*, 112 Q. J. ECON. 375 (1997); see also ALLOIS STUZLER & BRUNO FREY, WHAT COULD ECONOMISTS LEARN FROM HAPPINESS RESEARCH (2001).

seeks to suggest a fully comprehensive approach to contracts, it should not only deal with the *accuracy* of contracting (or, as behavioral economics suggests, with limited and biased cognitive abilities); rather, it needs to connect those two parts of the contracting process. The mental utility people would enjoy in a self-controlled bargaining process should be compared with the mental utility of the expected consequences of the contract. The monetary consequences for corporations, both in terms of their probability and their nature, will have a different mental impact depending on whether the consequences are achieved in harmony with the will of the parties, or as a consequence of a regulation or state intervention. Therefore, the theories examined here are concerned with both stages of the contract equation: the process of entering a contract, and the process of working within the terms of a contract.

#### A. THE LIMITS OF PSYCHOLOGICAL JURISPRUDENCE

In order to present the specific analysis of the ideal *perceived* amount of freedom people should exercise in the bargaining process, it is necessary to place the analysis within a broader context: namely, the efforts of psychology thus far to improve the assumptions of legal theory. One who looks through classical Law and Psychology literature is not likely to find many papers dealing with substantive legal theory in general, and with contracts in particular. This is true for several reasons. First, the Law and Psychology movement has taken a forensic approach to law.<sup>28</sup> The movement has focused its efforts on a low level of theoretical interaction with the goals of the law, as opposed to the fields of economics and sociology, which have taken a very dominant perspective on the ability of the law to promote efficiency and social change. Psychology has mainly focused on

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<sup>28</sup> For a full discussion of this topic see, Yuval Feldman, *Law and Psychology: Understanding The Current Interaction*, (1999) (unpublished manuscript, on file with the author). In this paper, the author addresses the reasons behind the tendency of psychologists to focus their efforts on certain areas of law such as child custody and criminal responsibility, as well as on procedural issues such as jury decision making and procedural justice. In part, some of the blame is placed on the current legal assumptions in civil law, which tend to neutralize the importance of the non-rational aspects of human behavior in those areas of law.

areas such as juries, eyewitness testimony, procedural justice, child custody, and in particular, the “mentally disadvantaged.”<sup>29</sup> Additionally, due to the total commitment of psychologists to empirical procedures, they have seldom asked broader policy questions that could not be answered empirically. The goals of psychology have been focused on exploring the behavioral assumptions of the legal system, and not on serving as a basis for normative legal theory. In this context, areas such as contracts, torts, property and corporations, which regulate everyday interactions among the majority of the population, have been largely ignored by the field of psychology. Consequently, psychology has never developed a dominant perspective within the literature on the theory behind these important areas in general, and contract theory in particular.<sup>30</sup>

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<sup>29</sup> *Id.*; see also Bruce A. Arrigo & Christopher R. Williams, *Law, Psychology, and the “New Sciences”: Rethinking Mental Illness and Dangerousness*, 46 INT’L J. OFFENDER THERAPY & COMP. CRIMINOLOGY 6 (2002).

<sup>30</sup> Within the literature of contracts and psychology, there are two areas in which one could find some consideration of psychological knowledge. The first area of literature deals with treatment contracts. This area is concerned with the therapeutic advantages of having contracts between the clinical psychologist and his patient. See Charlotte Sills, *Contracts and Contracting*, in CONTRACTS IN COUNSELING, 11 (Charlotte Sills ed., Sage 1997); Kirkland R. Schwitzgebel, *Treatment Contracts and Ethical Self-Determination*, 29 CLINICAL PSYCHOL. 5 (1976). The second area of literature deals with contracts on organizational psychology. See, e.g., Herbert G. Baker, *The Psychological Contract Between Employer And Employee*, 33 J. HUMAN BEHAVIOR 16 (1996). The most comprehensive description of the psychological environment of contracts in organizations from the perspective of organizational behavior can be found in DENISE M. ROUSSEAU, *PSYCHOLOGICAL CONTRACTS IN ORGANIZATIONS* (Sage 1995). Rousseau’s work is one of the rare instances where psychology has addressed contracts directly, and claims to offer a new paradigm for the role of contracts in organizations. Generally speaking, her theme is treating the relationships between employer and employee from the industrial psychology perspective, and the way it should make us treat the formal employment contract. She does not put any effort into trying to understand the implications of psychology on the legal theory of contract. Her interest is driven by the need to understand how to create the most efficient way of establishing employment relations. Nevertheless, this kind of literature does not say much about the psychological applications arising from the *legal* contracts. Another instance representative of the interaction between psychology and contracts is a paper in the legal tradition of equity’s approach to contracts, which treats the feeling of fairness perception as a key issue in the law of contracts. See, e.g., Jeffrey L.



## B. THE DISPUTE CONCERNING FREEDOM OF CONTRACT

The call to restrict the freedom of contract based on cognitive biases does not exist in a normative vacuum. There are various doctrines used to justify limitations on the freedom of contract. While the main point of this paper is that the behavioral case against the freedom of contract is fairly limited, it is important to recognize that the behavioral case is only one in a long list of doctrines all aimed at limiting the freedom of contract.<sup>31</sup> Moreover, most of the constraints on the freedom of contract that focus on public policy concerns and negative externalities could not be criticized from a behavioral point of view. However, against those arguments that base their justification on getting better outcomes for the individual parties, there are arguably unnoticed behavioral costs and benefits to the freedom of contract that should be included in the discussion. Behaviorally driven limitations should be evaluated by comparison to the existing justification for the restriction of the freedom of contract.

### i. *Classical Normative Treatment of the Importance of the Freedom of Contract*

Two obvious sources for the perspective on freedom of contract are economics and liberal theory. The recognition of the importance of people's freedom to decide for themselves which kinds of obligations and transactions to enter, has, for obvious reasons, been advocated by economic writers; the individual is the most efficient person to make decisions about her own transactions.<sup>32</sup> As Williston explains: "Adam Smith, Ricardo, Bentham, and John Stuart Mill successively insisted on freedom of bargaining as the fundamental and indispensable requisite of

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Harrison, *Class, Personality, Contract and Unconscionability*, 35 WM. & MARY L. REV. 445 (1995) (advocating a legal treatment which takes into account different concepts of justice and fairness and their influence on the parties' feeling satisfied with fairness of transactions).

<sup>31</sup> By advocating the behavioral advantages of bargaining and feeling in control over the contracts, the author is not suggesting that there should be no other consideration for freedom of contract besides psychology.

<sup>32</sup> THE ECONOMICS OF CONTRACT LAW (Anthony T. Kronman & Richard A. Posner eds., 1979).

progress; and imposed their theories on the educated thought of their times with a thoroughness not common in economic speculation.”<sup>33</sup>

The liberal tradition is the other prominent school of thought which has adopted the ideal of freedom. There are several philosophical foundations for the freedom of contract. Among these are the sovereignty of human will, sanctity of promise, and private autonomy against the intervention of the state.<sup>34</sup> These two traditions will serve as reference points when discussing what normative changes should be made by contract policy makers, who traditionally rely on economics and liberal thought when psychological arguments are taken into account.

## ii. *The Rise or Fall of the Freedom of Contract*

Clearly, the debate about the freedom of contract did not start with the recent bounded rationality line of research. There is a broader legal debate about the freedom of contract. The legal scholar most identified with the positive and normative arguments regarding the decline in the role of contracts is Atiyah.<sup>35</sup> Gilmore pointed out a few years before Atiyah that the remedies prescribed by the courts and the implied liabilities attached to contracts reduce the willpower of the parties in the contract to manage their own preferences through the contract.<sup>36</sup> Similar criticism<sup>37</sup> on the

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<sup>33</sup> Samuel Williston, *Freedom of Contract*, 6 CORNELL L. Q., 365, 366 (1921).

<sup>34</sup> See, e.g. Dori Kimel, *Neutrality, Autonomy and Freedom of Contract*, 21 OXFORD J. LEGAL STUD. 473 (2001).

<sup>35</sup> P.S. ATIYAH, *THE RISE AND FALL OF FREEDOM OF CONTRACT* (1979).

<sup>36</sup> GRANT GILMORE, *THE DEATH OF CONTRACT* 35-53 (1974). For more specific examples see Harold C. Havighurst, *Limitation upon Freedom of Contract*, 1979 ARIZ. ST. L.J. 167. It should be noted that there is no consensus on the above-mentioned position. In a philosophically oriented paper by Mark Pettit, Jr., *Freedom, Freedom of Contract, and the "Rise and Fall,"* 79 B.U. L. REV. 263 (1999), the author argues that in fact, the concept of freedom of contract limits the freedom of people who wish to escape the contract. *Id.* at 286. For example, if we easily enforce a contract, we force the will of the past on the will of the present (i.e., if someone has changed his mind). His major claim is that it is not true to say that freedom of contract has declined in the twentieth century, and that the question could be answered according to the definition of freedom. *Id.* at 276.

sanctity of the principle of freedom of contract has been shared by scholars such as Kessler<sup>38</sup> and Friedman.<sup>39</sup>

Nevertheless, it should be noted that a recent book edited by Frank Buckley, *The Fall and Rise of Freedom of Contract*,<sup>40</sup> tends to identify an opposing trend in the thinking about contracts from the 1970s through the 1990s. In the introduction to this book, the editor claims that in the 1990s freedom of contract was again rising.<sup>41</sup> The book brings together various types of evidence, both from a normative perspective and according to the abilities of parties to contract around existing laws (such as torts and marriage<sup>42</sup>). The editor tries to present a cumulative picture of the contract as an important tool, which is not as vulnerable to attack as Atiyah and Gilmore<sup>43</sup> have suggested.

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<sup>37</sup> See Eric Posner, *The Decline of Formality in Contract Law*, in THE FALL AND RISE OF THE FREEDOM OF CONTRACT (Frank H. Buckley ed., 1999) [hereinafter THE FALL AND RISE], where it is argued that in fact each one of the mentioned scholars is actually bringing a different perspective, and that there should be a distinction between the treatment of freedom and formality.

<sup>38</sup> Friedrich Kessler, *Contract of Adhesion – Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629 (1943).

<sup>39</sup> LAWRENCE FRIEDMAN, CONTRACT LAW IN AMERICA (1965).

<sup>40</sup> THE FALL AND RISE, *supra* note 37.

<sup>41</sup> THE FALL AND RISE, *supra* note 37 at 1-8.

<sup>42</sup> See Elizabeth S. Scott & Robert E. Scott, *A Contract Theory of Marriage*, in THE FALL AND RISE, *supra* note 37, at 201. In this paper, the authors intend to show that marriage is in fact a relational contract, and that in general there is a tendency toward privatization of family law.

<sup>43</sup> My focus on the writings of Atiyah and Gilmore is not intended to imply that this topic was not discussed in American academic writings. The most influential paper in the paternalism of courts in the law of contract is Kronman, *supra* note 11. For a discussion of the permissibility of some restrictions to freedom of contract also see Bailey Kuklin, *Self-Paternalism in the Marketplace*, 60 U. CIN. L. REV. 649 (1992), which discusses the philosophical foundations of the competing attitudes toward paternalism. For a completely different view on the meaning of personal freedom in the context of state paternalism, see Duncan Kennedy, *Distributive and Paternalist Motives in Contract and Tort Law, With Special Reference to Compulsory Terms and Unequal Bargaining Power*, 41 MD. L. REV. 563, 580 (1982).

Furthermore, in this same book, Epstein<sup>44</sup> and Posner<sup>45</sup> tend not only to argue about the change that occurred in the period between the 1970s and the 1990s, but also to attack the basic arguments of Atiyah and Gilmore.<sup>46</sup> They claim that these scholars do not present a clear view of the twentieth-century process and its causes. According to their analysis, there is no clear distinction between freedom and formality, or between sanctity of contract and security of exchange.<sup>47</sup> Therefore, they call into question Atiyah and Gilmore's initial assumptions that the motivation of the courts is related to the political view identified with laissez-faire and the free market.<sup>48</sup>

### iii. *Atiyah's Claim*

Atiyah's influential book, *The Rise and Fall of Freedom of Contract*,<sup>49</sup> describes two important periods in the development of contracts. The first occurred in the late eighteenth century, when there was a transformation from status to contract. In this period, from about 1770 to about 1870, more importance was placed on free will, the rise in personal autonomy, and self-regulation. The

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<sup>44</sup> Richard A. Epstein, *Contracts Small and Contracts Large: Contract Law Through the Lens of the Laissez-Faire*, in *THE FALL AND RISE*, *supra* note 37, at 25.

<sup>45</sup> Posner, *supra* note 37, at 61-78.

<sup>46</sup> Posner, *supra* note 37, at 62; Epstein, *supra* note 44, at 46.

<sup>47</sup> Posner, *supra* note 37, at 64; Epstein, *supra* note 44, at 48.

<sup>48</sup> As previously mentioned, the intent of this paper is neither to reconcile the different views regarding what happened to freedom of contract, nor to describe the political background of the trends in the courts' treatment of contracts. Rather, the intent is to suggest a different perspective on the process described by Atiyah in his book, especially under the normative "psychological" justification given to paternalism by Zamir, *supra* note 16, and, to a lesser extent, Eisenberg, *supra* note 20, and Sunstein, *supra* note 14. Given that the reverse trend described in Atiyah's book *The Rise and Fall of Freedom of Contract* is justified from a political perspective on society, and not from an individual perspective, the existence of such a trend does not undermine the importance of the current discussion. Thus, even if Atiyah was wrong in his observation, and there was an increase in the control people were allowed by the state, the individual's motivational and emotional reaction to that control, and the wisdom of giving people control in these areas, could be informed by this analysis.

<sup>49</sup> ATIYAH, *supra* note 35.

legal scholars at the time described this as “the move from status to contract.”<sup>50</sup>

Atiyah claims that the wheel came full circle after 1870, when there was a movement from contract to status.<sup>51</sup> According to him, several parallel forces were responsible for that: the economic decline in the use of contract in the twentieth century due to the creation of alternative methods of macro regulations on our lives; the perception of the contract as a tool for allocating risks, which is used only to enable exchange; and the decline in the importance of free choice as a source of one’s rights and obligations.<sup>52</sup>

Atiyah’s observations can be reduced to the following six categories:

1. Limits on the parties with whom one can contract;
2. Limits on the areas in which one could contract (e.g. consumer, employee rights, liability exclusion clauses);
3. The active role of courts when enforcing the contracts (e.g. the ability of courts to adjust the terms of the contract; general increase in the circumstantial factors courts could consider when required to enforce a contract);
4. The emergence of doctrines such as good faith, unconscionability and fairness;
5. Rules of interpretation -- putting the parties’ intent in social and commercial contexts;

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<sup>50</sup> ATIYAH, *supra* note 35, at 716.

<sup>51</sup> ATIYAH, *supra* note 35, at 716-71.

<sup>52</sup> Without downplaying the importance of the first two factors, the focus here is on the reasons for the declining importance of free choice and the rise of protectionism by the state, and to analyze whether or not this theoretical shift is justified according to the principles of social psychology. This decline is especially troubling in terms of the other trends in the twentieth century, which by and large recognized the significance of the freedom of citizens to live their private lives (practicing abortion, homosexuality, etc.) without interference from the state. ATIYAH, *supra* note 35, at 726-27. One famous example revealing the importance of free choice is the ability of parties to form contracts to allocate their liability. For a law and economics critique on contracting around liability, see Robert D. Cooter, *Commodifying Liability*, in *THE FALL AND RISE*, *supra* note 37, at 139.

6. Standardization of relations -- the extensive use of regulation and form contracts having reduced the opportunities for self-bargained contracts.<sup>53</sup>

With the exception of the first category,<sup>54</sup> all of these categories are relevant to the sense of control an individual will have over her contract once she signs it, and to the number of opportunities an individual will actually have to sign contracts. The introduction of doctrines that allow courts to consider factors aside from the intention of the parties signal to people that what they actually say and do in the contracting process will not necessarily matter when and if this contract becomes litigated.

The basic dichotomy of the circumstances courts take into account when enforcing contracts are:

1. Information failures: twentieth-century courts are more sensitive to gaps in information regarding the terms of the transactions;

2. Externalities: courts are more sensitive to contracts that have a negative impact on third parties;

3. Commodification: humanistic values aside from personal autonomy put restrictions on the circumstances in which people may contract;

4. Paternalism: the traditional perspective of autonomy should be balanced with a realization of the mental capabilities of people.<sup>55</sup>

From the normative perspective, the focus here will be on the first and fourth categories: information gaps and paternalism. These two categories represent the leading normative theme that underlies the treatment of the freedom of contract: How can we get

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<sup>53</sup> ATIYAH, *supra* note 35 at 717-78.

<sup>54</sup> The first category focuses on the anti-discrimination provision that limited the freedom not to contract with certain individuals based on race, gender or religion. Such provisions are relevant on a societal level and have less effect on the individual's sense of control, when she tends to bargain over the contract.

<sup>55</sup> See Michael J. Trebillock, *External Critiques of Laissez-Faire Contract Values*, in THE FALL AND RISE, *supra* note 37, at 78-93. Without an empirical examination of the frequency and impact of each of these claimed changes, the actual practices of all courts regarding the different policies described by Atiyah cannot be shown. Nevertheless, the existence of these policies enables one to determine from a theoretical perspective the predictable effects of those policies on the parties' mental well-being.

the best bottom line? This approach is backed by economic theory that tends to favor individual control over the contract, as long as such control is likely to move value to the party who wants it most.

### C. THE ACTIVE ROLE OF COURTS IN THE ENFORCEMENT OF CONTRACTS

It is the suggestion of this author that the use of psychology to decide whether the state should intervene in the freedom of contract should not be based solely upon the knowledge of when a person is most likely to make mistakes; rather it should attempt to understand when control will be a source utility and when it will be a source of disutility for the individual.

However, the argument in favor of the psychological advantages of control should not be over-stated. Naturally, public policy brings about the basic question of whether we could even do a cost-benefit analysis of the interest of the public versus the interest of the individual.<sup>56</sup> In this context, it is not the aim of this paper to suggest the psychologically imperialistic argument that the individual's mental well-being is more important than the public's interests are.<sup>57</sup> Nevertheless, there are reasons to think that well-being consideration could be incorporated into contract theory, while still accounting for traditional elements of contract theory.

#### i. *The Threat to Individual's Sense of Control From Courts' Active Role in Interpreting and Enforcing Contracts, Implied Meaning and Good Faith*

The new role of courts when interpreting contracts, and the factors they take into account, could signal to individuals that their personal control over the contract is limited. The traditional

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<sup>56</sup> See RESTATEMENT (SECOND) OF CONTRACTS § 207 (1979), which states that when there are two meanings to the contract and public interest is involved, a meaning favoring public interest should be selected.

<sup>57</sup> See Friedrich Kessler & Edith Fine, *Culpa in Contrahendo, Bargaining in Good Faith, And Freedom of Contract: A Comparative Study*, 77 HARV. L. REV. 401 (1964) (comprehensively discussing the tension between the interests of the individual and the public interests in contracts).

approach of courts in the interpretation of contracts is that the courts do not make contracts for the parties.<sup>58</sup> However, to some extent the court will make contractual obligation for parties in order to impress upon them duties of good faith and fair dealing. As Lord Wright says:

The truth is that the court, or jury, as judge of fact, decides this question in accordance with what seems to be just and reasonable in its eyes. The judge finds in himself the criterion of what is reasonable. The court is in this sense making a contract for the parties – though it is almost blasphemy to say so. But the power of the court to do this is most beneficial, and indeed even essential.<sup>59</sup>

Or, as stated by Corbin,

In order to prevent the disappointment of expectations that the transaction aroused in one party, as the other had reason to know, the courts find and enforce promises that were not put into words, by interpretation when they can and by implication and construction when they must.<sup>60</sup>

Similarly, Williston states that when a contract is unambiguous, the court should not rewrite it to save a party from an undesirable outcome. Nevertheless, when several interpretations are possible, the courts are free to examine the reasonableness of the transaction.<sup>61</sup>

In a recent paper which examines the role of American courts in interpreting contracts, Eyal Zamir concludes that even in the initial interpretation stage of reading the contract, the meaning of the contract is based on various aspects of fairness, equality and

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<sup>58</sup> 3 ARTHUR L. CORBIN, CORBIN ON CONTRACTS 94 (West 1960).

<sup>59</sup> 3 *id.* at 95 n. 69 (quoting Lord Wright, in *Legal Essays and Addresses*, at 259).

<sup>60</sup> 3 *id.* at 97.

<sup>61</sup> 11 SAMUEL WILLISTON, A TREATISE ON THE LAW OF CONTRACT 468 (4th ed. 1999) (citing *Consumers Ice Co. v. United States*, 201 Ct. Cl. 116 (1973)).



like principles.<sup>62</sup> The intentions of the parties are not necessarily one of the foremost factors to be included in the interpretation process. Zamir makes an “empirical observation” in which he examines the twenty cases mentioned in *American Jurisprudence*<sup>63</sup> as representative examples of cases following the plain meaning rule.<sup>64</sup> Zamir shows that even among the cases on this list, only two actually follow the plain meaning rule. In all the other cases mentioned, courts considered other factors such as justice, fairness and reasonableness. Zamir further claims, based on Cohen’s classic paper,<sup>65</sup> that the perception that contract law is mainly interested in promoting the will of the parties is not necessarily the leading one in the Anglo-American legal system.<sup>66</sup> The contract could very well be a tool used to incorporate the societal values of public policy, fairness, and equality into market transactions. The position suggested by Zamir is similar in many ways to the equity tradition, which advocates the concept of fairness. Consequently, a contract will not be enforced if it will lead to substantive unfairness,<sup>67</sup> even if the party herself has agreed to it. Thus, according to the equity tradition in contract law, the will of the party will be enforced only if it does not raise issues of unfairness.

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<sup>62</sup> Eyal Zamir, *The Inverted Hierarchy of Contract Interpretation and Supplementation*, 97 COLUM. L. REV. 1710 (1997)

This section dealt with some of the central rules of interpretation employed by courts in determining a contract’s meaning. Since they refer to the first stage of the process under the conventional hierarchy, interpretation of the contract text itself, one might have expected these rules to concentrate on revealing the parties’ intentions. In fact, the rules serve various goals, *the ascertainment of the parties’ intentions not necessarily foremost among them*. Courts interpret contracts to give them a reasonable, lawful, and fair meaning, a meaning that favors the public, enhances equality between customers, serves efficiency, redistributes power and wealth between the parties, and protects people from their miscalculations.

*Id.* at 1731 (emphasis added).

<sup>63</sup> 17A AM. JUR. 2D *Contracts* § 337, n.89 (1991).

<sup>64</sup> Zamir, *supra* note 62, at 1729-30.

<sup>65</sup> Morris R. Cohen, *The Basis of Contract*, 46 HARV. L. REV. 553 (1964).

<sup>66</sup> Zamir, *supra* note 62, at 1714.

<sup>67</sup> Larry A. DiMatteo, *Equity’s Modification of Contract: An Analysis of the Twentieth Century’s Equitable Reformation of Contract Law*, 33 NEW ENG. L. REV. 265, 267 (1999).

If such unfairness exists, the courts could avoid enforcing the contract, *even if the parties themselves never requested any cancellation.*

Another doctrine contributing to the decline in the freedom of contract is the extensive use of "good faith,"<sup>68</sup> which, while appearing to encourage reasonable commercial standards, places a very strong restriction on the concept of individual control in the life of the contract.<sup>69</sup> As noted by Jean Braucher, "We imply a term to give effect to our sense of justice rather than to give effect to what these particular parties intended."<sup>70</sup> This kind of interpretation obviously limits the freedom of contract, and consequently reduces the parties' perception of themselves as the sources of their contract relations.

It is worth noting that the interpretation of plain words is only one opportunity for courts to modify the original intention of the parties in the contract. Many other legal tools enable courts to use societal values to reduce the importance of the will of the parties when enforcing contracts. For example, in the case of *Toussaint v. Blue Cross*, the employee's personnel manual said that it "[is the policy of the company] to treat employees leaving Blue Cross in a fair and consistent manner and to release employees for just cause only."<sup>71</sup> It was clear that under longstanding law, this statement would not be sufficient to overcome the at-will presumption, in part because no term of years was identified.<sup>72</sup> Nonetheless, the Michigan Supreme Court held that this was sufficient to create an obligation of continued

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<sup>68</sup> RESTATEMENT (SECOND) OF CONTRACTS § 205 (1979); Steven J. Burton, *Breach of Contract and the Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369 (1980).

<sup>69</sup> Kevin M. Teeven, *Decline of Freedom of Contract Since the Emergence of the Modern Business Corporation*, 37 ST. LOUIS U. L.J. 117, 143-56 (1992).

<sup>70</sup> Jean Braucher, *Contract versus Contractarianism: The Regulatory Role of Contract Law*, 47 WASH. & LEE L. REV. 697, 700 (1990).

<sup>71</sup> 292 N.W.2d 880, 893 (Mich. 1980). *But see* *Rowe v. Montgomery Ward & Co.*, 473 N.W.2d 268 (Mich. 1991) ("[T]he [*Toussaint*] theory remains troubling because of those instances in which application of contract law is a transparent invitation to the factfinder to decide *not* what the 'contract' was, but what 'fairness' requires.").

<sup>72</sup> *Id.* at 885.

employment, notwithstanding the absence of a specified term of years.<sup>73</sup>

Courts have also used good faith as a reason to read into contracts a duty to adjust contracts to changing circumstances, especially in long-term cases.<sup>74</sup> This procedure obviously has some advantages when it is used to prevent the parties from continuing in a contract, which is bad for both of them. Nevertheless, even the supporters of the active role of courts in filling gaps and adjusting the terms of contracts would admit that this procedure carries with it some threat to the freedom of contract, especially when the contract is not well written.

In sum, the policies and theories described present the role of the court in enforcing contracts as somewhat more than an institution whose sole purpose is to understand what contracting parties intend. Courts are allowed to consider other policy factors such as fairness and good faith. Such a role for courts, if known and explained to the parties ex-ante, necessarily limits their sense of control over the contract.

## ii. *Unconscionability*

Perhaps the most representative example of a doctrine that brings the tension between security and control to its furthest extreme is the doctrine of unconscionability.<sup>75</sup> Section 2-302 of the Uniform Commercial Code is the current source of the court's ability to police the fairness of the terms in contracts. Nevertheless, many of the common law doctrines regarding disclosure and formation of contracts could give courts similar

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<sup>73</sup> *Id.* But see Jonathan R. Macey, *Courts and Corporations: A Comment on Coffee*, 89 COLUM. L. REV. 1692 (1989) (discussing the active role of the courts in interpreting contracts as an important factor in the protection of shareholder welfare).

<sup>74</sup> See Robert A. Hillman, *Court Adjustment Of Long-Term Contracts: An Analysis Under Modern Contract Law*, 1987 DUKE L.J. 1 (claiming that if done in the right manner, unconscionability could improve the contract relations, and should result in a big change for the parties' costs when framing contracts).

<sup>75</sup> RESTATEMENT (SECOND) OF CONTRACTS § 208 (1979); M. P. Ellinghaus, *In Defense of Unconscionability*, 78 YALE L.J. 757 (1969).

powers.<sup>76</sup> The basic framework for analyzing unconscionability follows the basic dichotomy in UCC section 2-302, between procedural and substantive unconscionability.<sup>77</sup>

The first type, procedural unconscionability, focuses on the process of contract formation. If the court perceives that one of the parties has entered the contract without full awareness of the terms of the contract, the court can refuse to enforce the contract.<sup>78</sup> It seems reasonable to argue from a normative perspective that if the parties are not fully aware, there is no threat to the freedom of contract, since by definition, no contract was actually signed by the parties.<sup>79</sup> Nonetheless, extensive use of this doctrine could have a psychological impact. Thus, although there is no intended interference with a party's autonomy, from the parties' perspective procedural unconscionability adds some unpredictability to the enforcement process. This is especially true when it is not clear to both parties that this kind of unconscionability occurred.

The second type, substantive unconscionability, enable courts to actually review the content of a contract's terms and decide whether those terms are fair. Naturally, this doctrine has attracted more criticism for the power it gives the courts.<sup>80</sup> From the perspective of the mental impact on the parties, it also seems to

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<sup>76</sup> Robert A. Hillman, *Debunking Some Myths About Unconscionability: A New Framework for U.C.C. Section 2-302*, 67 CORNELL L. REV. 1 (1981) (arguing that understanding the historic background in the common law would lead to a completely different understanding of the power courts received from that section).

<sup>77</sup> Arthur A. Leff, *Unconscionability and the Code – The Emperor's New Clause*, 115 U. PA. L. REV. 485 (1967). Though, note that all scholars do not accept this distinction. For a review of this disagreement, see Michael J. Philips, *Unconscionability and Article 2 Implied Warranty Disclaimers*, 62 CHI-KENT L. REV. 199 (1985).

<sup>78</sup> Trudy Nobles Sargent, *Unconscionability Redefined: California Imposes New Duties on Commercial Parties Using Form Contracts*, 35 HASTINGS L.J. 161, 163-66 (1983).

<sup>79</sup> In fact, one could argue safely that most commentators tend to favor procedural over substantive unconscionability for this obvious reason. For a complete analysis of the rationale behind a distinctive approach to unconscionability, see Richard A. Epstein, *Unconscionability: Critical Reappraisal*, 18 J.L. & ECON. 293 (1975).

<sup>80</sup> See Harry G. Prince, *Unconscionability in California: A Need for Restraint and Consistency*, 46 HASTINGS L. J. 459, 554 (1995) (reviewing the various opinions for and against unconscionability).

be a much more harmful doctrine because it not only impedes the parties' ability to predict the enforcement process, but also directly undermines their actual control of the contract. Therefore, the application of the doctrine raises the possibility of threatening the parties' sense of control and affiliation in the contract.<sup>81</sup>

Another related doctrine focuses on the unequal bargaining positions of the parties. For example, in the United Kingdom there is a requirement that a landlord's refusal to let a tenant sublet his apartment should be reasonable, no matter what was outlined in the contract.<sup>82</sup> According to another English law,<sup>83</sup> an employer cannot fire a worker even in accordance with a contract, if it is interpreted as an "unfair dismissal."<sup>84</sup>

### iii. *The Decline in Actual Use of Bargained Contracts*

Another market driven phenomenon relates to the actual use of contracts. Unlike the scholars previously mentioned, who recommend a normative change in the perceived importance of the freedom of contract versus values such as fairness and equality, scholars writing about this phenomenon suggest a decline in the *opportunities* people have to actually use contracts.<sup>85</sup> Part of this decline is connected with changes in the perception of the contract as an efficient way to manage longitudinal relations in organizations.<sup>86</sup> Another source for this change is the increased usage of form contracts by corporations that need to negotiate with

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<sup>81</sup> In fact, according to some commentators, the use of substantive unconscionability is in major decline in the U.S. See Craig Horowitz, *Reviving the Law of Substantive Unconscionability: Applying the Implied Covenant of Good Faith and Fair Dealing to Excessively Priced Consumer Credit Contracts*, 33 UCLA L. REV. 940 (1986) (reviewing the law of substantive unconscionability).

<sup>82</sup> *The Landlord and Tenant Act 1927*, § 19, see ATIYAH, *supra* note 35 for further discussion.

<sup>83</sup> *The Industrial Relations Act 1971* (Eng.).

<sup>84</sup> For the proposed United States rule, see *Model Employment Termination Act*, reprinted in MARK ROTHSTEIN AND LANCE LIEBMAN, *EMPLOYMENT LAW* 208-19 (1997) (Statutory Supplement).

<sup>85</sup> See Steven R. Salbu, *The Decline of Contract as a Relationship Management Form*, 47 RUTGERS L. REV. 1271 (1995).

<sup>86</sup> *Id.*

masses of people in only a few typical transactions.<sup>87</sup> Obviously, even if an individual has control over whether to engage in the form contract, the sense of control in “take-it-or-leave-it” contracts is limited, especially if there is little variation between the different types of form contracts a corporation uses.

In many aspects, the individual’s choice and responsibility over how to manage her interactions with society is becoming -- according to the various doctrines presented above -- more and more limited. The state, through regulations in specific areas, and courts’ active role in the enforcement of contracts and the interpretations and incorporation of social norms, can change the classically strict notion of the autonomy of a contract. There is reason to believe that an individual today, while engaging in the contracting process, could feel that she had limited control over the way a contract will look. From that perspective, the recent call for an increase in paternalism over the control of contracts, due to the parties’ cognitive biases,<sup>88</sup> is aggravating a situation in which the individual’s sense of control over the contracting process is already diminishing.

## II. THE ADVANTAGES IN INCREASING THE PERCEIVED FREEDOM OF CONTRACT FROM A SOCIAL PSYCHOLOGICAL PERSPECTIVE

Some of the relevant theories that have been gathered in social psychology illuminate the positive aspects of individual control in contracts. There are some possible claims that social psychology could make in favor of more limited involvement of the courts in contract enforcement and against the tendency of state regulations to limit the areas in which people can form contracts. Courts, or the legislature, try to protect the interest of the parties in contracts (especially the weaker ones) by either constructive interpretation, or through regulations limiting the use of contracts in certain areas. Additionally, due to changing economic conditions, the actual use of contracts is limited (form contracts, unionization, etc). The conclusion could follow that these limitations by the state could cause unintended harm to the

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<sup>87</sup> Teeven, *supra* note 69, at 125.

<sup>88</sup> See discussion *supra*, Part I.

parties.<sup>89</sup> From a psychological perspective, intervention may make a situation worse. The psychological benefits of control will be discussed in two therapeutic dimensions. The first is improving well-being as an end in and of itself. The second is increasing bargaining in order to improve contractual commitment. The second line of reasoning could be justified even from an expected utility perspective, since adaptive behavior could increase the chances of maintaining contractual behavior and hence cooperation and productivity.<sup>90</sup> So, for example, from a cost-benefit analysis, one could argue that the transaction costs which are being saved with the use of form contracts should be calculated against the costs which could be saved by using bargained contracts, due to improved adaptive abilities.

#### A. PERCEIVED CONTROL OF CONTRACTS AND WELL-BEING

In the last few years, there has been growing interest among psychology researchers in the scientific study of well-being. This interest has led researchers to try to measure well-being and understand the factors in life that can affect an individual's sense of well-being.<sup>91</sup> This area of research is still in its early stages, and has not achieved, to date, the same robustness as the research on cognitive biases commonly used by law and economics scholars. Nevertheless, while keeping this limitation in mind, the potential of that research for legal policy is too valuable to be left outside the current policy debate on freedom of contract.

Another way to treat the trade-off between meaningful procedure and accurate outcome is the distinction between expected utility and experience utility. The possibility of re-evaluating Bentham's original perception of utility is suggested by

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<sup>89</sup> This is the Nirvana fallacy, which means that just because there is a market failure, state intervention may not really solve the problem. See Ian Ayres & Stewart J. Schwab, *Employment Contract*, 8 KAN. J.L. & PUB. POL'Y 71 (1999) (discussing problems of asymmetric performance).

<sup>90</sup> Lawrence C. Permulter & Richard A. Monty, *The Importance of Perceived Control: Fact or Fantasy?*, 65 AM. SCIENTIST 759 (1977).

<sup>91</sup> Daniel Kahneman, *Objective Happiness*, in WELL-BEING: THE FOUNDATIONS OF HEDONIC PSYCHOLOGY 3-25 (Daniel Kahneman & Ed Diener eds., 1990) (calling for the emergence of a new field of study within psychology) [hereinafter WELL-BEING].

Kahneman in his paper, *Back to Bentham? Explorations of Experience Utility*.<sup>92</sup> In this paper, Kahneman explores whether economics will accept the idea that people's irrationality should be perceived not only as a reason for limiting their freedom (due to their alleged distorted perception of the relevant information), but also as a reason to look for benefits which are not solely based on the outcome a rational decision maker would seek. However, although this concept has been developed, economists have not yet revisited the concept of subjective utility and the possible implications of experience utility to the models of economics into the law.<sup>93</sup> Therefore, the challenge for the field of psychology, if it is to adopt a similar role to that of economics in legal theory, will be to model the experience utility into some predictable order. Being able to predict ex-ante the experience utility of people in different contractual situations will enable scholars of psychology to take advantage of the mathematical modeling of economics and create some solid implications for legal policy, which, at least in civil law, has mostly accepted the rationale of welfare maximization as a justified purpose to consider.

The theory in the area of the relationship between control and well-being seems to be straightforward. As Thompson summarizes the idea, "We feel better about ourselves, we are physically healthier, perform better under adversity, and are better able to make desired behavioral changes if we have a sense of behavioral control."<sup>94</sup>

In other words, one could argue that giving a person the feeling that she is controlling a transaction and its fulfillment will have a positive effect on the person's well-being.<sup>95</sup> The improvement in personal well-being through an increase in the

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<sup>92</sup> The main paper dealing with the suggestion of revisiting subjective utility is Daniel Kahneman et al., *supra* note 27. Kahneman's better-known work on cognitive biases, *supra* note 24, is the basis for the new behavioral economics.

<sup>93</sup> But see Brunu Frey & Alois Stultzer, *Measuring Process Utility* (2002)(working paper) (on file with author).

<sup>94</sup> Suzanne C. Thompson, *Naturally Occurring Perception of Control: A Model of Bounded Flexibility*, in *CONTROL MOTIVATION AND SOCIAL COGNITION* 74-93 (Gifford Weary et al eds., 1993) [hereinafter *CONTROL MOTIVATION AND SOCIAL COGNITION*].

<sup>95</sup> Susan Folkman, *The Personal Control and Stress and Coping Processes: A Theoretical Analysis*, 46 J. PERS. AND SOC. PSYCHOL. 839 (1984).



dominance of contracts in our everyday activity could be shown from a different perspective as well. Some researchers take the position that one's daily activity aimed at achieving future goals (referred to as "the implicit agency of daily life") has an important value for one's well-being.<sup>96</sup> Translating this concept to the research question under consideration here supports the therapeutic advantages of using personally negotiated contracts,<sup>97</sup> and not prewritten form contracts, collective contracting, or state regulations. Thus, the larger the percentage of one's daily activity that is controlled by contracts, the greater one's level of well being will be. Ex-ante limitation on individual bargaining will lead to a loss in personal control that could have a negative impact on one's emotional adaptive abilities.

#### **B. MENTAL REPRESENTATION AND THE IMPORTANCE OF THE CONTRACTING PROCESS**

The importance of self-contracting is highly supported by social cognition literature. Taylor and Pham claim that the ability to form a mental representation of one's goals has a positive influence on one's ability to cope with difficulties while working toward those objectives.<sup>98</sup> Although not suggested directly by the aforementioned authors, a contract theory which enables people to engage in as detailed a contract as possible (as opposed to form contracts or state regulations), could help people visualize their goals through the process of contracting. Taylor writes, "The simple act of forming an intention to implement an action

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<sup>96</sup> Laura. A. King, *Personal Goals and Personal Agency: Linking Every Day Goals to Future Images of the Self*, in PERSONAL CONTROL IN ACTION 109 (Miroslaw Kofta et al. eds., Plenum 1998).

<sup>97</sup> The hard questions, which this kind of statement raises, are what happens when the same goals are not achieved by contracting, and what is the difference that we are willing to tolerate in order to justify self-regulations within one's daily business.

<sup>98</sup> Shelley E. Taylor & Lien B. Pham, *Mental Simulation, Motivation, and Action*, in P. GOLLWITZER, & J. BARGH, THE PSYCHOLOGY OF ACTION 219 (Guilford 1996) [hereinafter THE PSYCHOLOGY OF ACTION]; Lien B. Pham & Shelley E. Taylor, *From Thought to Action: Effects of Process- Versus Outcome-Based Mental Simulations on Performance*, 25 PERS. & SOC. PSYCHOL. BULL. 250-60 (1999.)

facilitates the detection of action-related opportunities, intensifies commitment to the action sequence, and leads to a high likelihood of actions.”<sup>99</sup>

Accordingly, the more detailed the contract is, the greater the chance that a person will honor the contract terms. Given the complexities of real cases (the use of lawyers, transaction costs of detailed contracts, and so on), detailed contracts are not always possible. Nevertheless, the utility of mental representations could suggest that the state might benefit citizens by encouraging them to contract in areas which are now traditionally controlled by form contracts, such as union bargaining, and cogent state regulations -- especially in long-term contracts. Enabling easy access to the courts by the presumed weaker party might reduce the fear that the bargaining process could lead to bad contract outcomes. According to this school of thought, the more people engage in self regulation of their futures, the more able they will be able to cope with any psychological stress resulting from the contract.<sup>100</sup> In other words, from the perspective of mental representation, the disutility resulting from the restriction of the freedom of contract is due to the fact that in certain areas, people do not currently have the option to use bargained contracts because of paternalistic and commercial constraints. The other source of restriction on the freedom of contract, which results from the active role of courts in the interpretation of contracts, seems to be less of a problem from the mental representation perspective.<sup>101</sup> Since what is important in this context is to enable people to plan in advance of their transactions, the ex-post intervention of courts does not undermine the potential utility of bargaining. What is being challenged by both ex-ante state regulation and ex-post court intervention is the individual's sense of control over her commercial interactions.

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<sup>99</sup> Taylor & Pham, *supra* note 98, at 229.

<sup>100</sup> For an application of the above claim to some more specific circumstances, see Inna D. Rivkin & Shelley E. Taylor, *The Effects of Mental Simulation on Coping with Controllable Stressful Events*, 25 PERS. & SOC. PSYCHOL. BULL. 1451 (1999).

<sup>101</sup> This distinction is true with regard to the implicit agency theory, discussed in the previous section.

### C. SENSE OF CONTROL AND ACTUAL CONTROL

The meaning of freedom in the context of this paper mostly relates to having a *sense* of control as opposed to having *real* control. For example, giving a person the option to contract on the terms of a transaction or on the terms of an employment relationship does not necessarily allow her to control the outcome. Market and social constraints will in most cases lead to a situation in which only part of a person's initial position will be in the final contract. Regardless, this person could still have a sense of control, since she will likely feel that she has chosen what terms she is willing to give up in order to enter the contract.

It has long been recognized that a sense of freedom is sometimes so important to people that they will even avoid choosing the most desirable outcome just to preserve, in their eyes, their freedom of choice and their control over outcomes.<sup>102</sup> People in a situation in which they lack control will become even more sensitive to that need.<sup>103</sup> In addition, under certain circumstances, a sense of control could also ease the acceptance of negative events.<sup>104</sup>

The motivation to control and influence one's life could also be explained in terms of preserving one's perception of self and improving the self's symbolic value, maintaining one's sense of life management and controlling one's inner fears about existence.<sup>105</sup> Recently, Muraven, Tice and Baumeister described the desire for control (as well as self esteem) as one of the basic and important underlying forces of the self.<sup>106</sup>

It has been shown, for example, that people find it easier to deal with consequences of acts that they have chosen rather than

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<sup>102</sup> Jack W. Brehm & Elena Rozen, *Attractiveness of Old Alternatives When a New Attractive Alternative is Introduced*, 20 J. PERS. & SOC. PSYCHOL. 261 (1971).

<sup>103</sup> Jack W. Brehm, *Control, Its Loss, and Psychological Reactions*, in CONTROL MOTIVATION AND SOCIAL COGNITION, *supra* note 94, at 3.

<sup>104</sup> Suzanne C. Thompson, *Will It Hurt Less if I Can Control It? A Complex Answer to a Simple Question*, 90 PSYCHOL. BULL. 89 (1981).

<sup>105</sup> Thomas A. Pyszczynski et al., *A Terror Management Perspective on the Psychology of Control*, in PERSONAL CONTROL IN ACTION, *supra* note 96, at 85.

<sup>106</sup> Mark Muraven et al., *Self-Control as a Limited Resource: Regulatory Depletion Patterns*, 74 J. PERS. & SOC. PSYCHOL. 774 (1998).

situations over which they have no control.<sup>107</sup> Also, there is a correlation between one's commitment to the achievement of a goal and the perception of control, known as "commitment to goal achievement hypothesis."<sup>108</sup>

Presenting a different view, Bandura's research on learned helplessness indicates that as long as the state gives people the feeling that they are not capable of managing their own lives, they will lose their ability to take care of themselves.<sup>109</sup> Bandura advocates getting people to actually believe in their self-efficacy. Strong paternalism in the courts, especially when dealing with lower socioeconomic classes, could, in that context, be harmful to people's self-efficacy.

It is reasonable to conclude that in a legal system where citizens believe that the state does not trust their abilities to make wise decisions (e.g. as a consumer who buys a product, or as a worker who negotiates her terms), their feelings of efficacy and personal control will be affected both by ex-ante regulations that prevent contracting, and by ex-post intervention that takes a paternalistic position over their welfare.

The mission of the state, according to this theory, is to let people *think* that they have control in contracts, even if they do not really have very much control.<sup>110</sup>

#### D. FREEDOM OF CONTRACT AND PERSONAL COMMITMENT

The importance of personal choice on one's behavior, and the impact of that choice on one's commitment to pursue this behavior, is a shared intuitive belief, used widely by salespeople

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<sup>107</sup> Darwyn E. Linder et al., *Decision Freedom as a Determinant of the Role of Incentive Magnitude in Attitude Change*, 6 J. PERS. & SOC. PSYCHOL. 245 (1967).

<sup>108</sup> Peter M. Gollowitz & Ronald F. Kinney, *Effects of Deliberative and Implemental Mind-Sets on Illusion of Control*, 56 J. PERS. & SOC. PSYCHOL. 531 (1989).

<sup>109</sup> Albert Bandura, *Self-Efficacy: Toward a Unifying Theory of Behavior Change*, 84 PSYCHOL. REV. 191 (1977).

<sup>110</sup> Such treatment of individuals by the state might bring to mind the common Marxist notion of false consciousness.

and personal managers in organizations.<sup>111</sup> The importance of personal acceptance implies that if people are willingly committed to a goal, they are more likely to adhere to that commitment.<sup>112</sup> The underlying implication here is that, by restricting people's ability to negotiate because of various psychological and economic considerations, the state is overlooking the mental benefits of self-control.

The cognitive dissonance theory<sup>113</sup> is another theory that recognizes the influence of one's motivation to accomplish a mission. In this context, one could think of the creation of a contract as a situation in which one is actually being forced to comply with a form *different* from that that was initially preferred. Thus, in many cases the contract is a meeting in the middle between the two parties and is therefore not exactly what each party wanted. Nevertheless, when a person signs a contract, she needs to justify the dissonance between that decision and her initial position by reassuring herself that she, in fact, knows "how to do business." In this way, the interesting question for a policy maker is whether it is mentally advantageous to promote the creation of that dissonance, or to encourage people to be more realistic about the fairness and efficiency of a contract.

The question becomes even more disturbing when one considers some findings on the negative effects of cognitive dissonance on the persons experiencing it.<sup>114</sup> It seems problematic to use cognitive dissonance as a tool to cause people to feel more committed to contracts in which they have bargained. On the other hand, cognitive dissonance could be helpful in overcoming

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<sup>111</sup> See, e.g., ROBERT B. CIALDINI, *INFLUENCE: SCIENCE AND PRACTICE* 76-80 (Harper Collins College Publishers 3d ed. 1993).

<sup>112</sup> Edwin A. Locke et al., *Goal Setting and Task Performance*, 90 PSYCHOL. BULL. 125 (1981).

<sup>113</sup> LEON FESTINGER, *CONFLICT, DECISION, AND DISSONANCE*. (Stanford U. Press 1964); see also, Leon Festinger, *A Theory of Cognitive Dissonance* (Row Peterson 1957).

<sup>114</sup> Mary E. Losch & John Cacioppo, *Cognitive Dissonance May Enhance Sympathetic Tonis, But Attitudes Are Changed to Reduce Negative Effect Rather Than Arousal*, 26 J. EXPER. SOC. PSYCHOL. 289 (1990).

feelings of regret about past actions,<sup>115</sup> which is very common in contract situations. Thus, it is a reasonable speculation that the higher the perceived choice of one's contract, the more likely one is to justify the advantages in a contract and behave accordingly. Correspondingly, the more courts take an active position in interpreting contracts, the more individuals will feel that their signatures are contingent upon approval by a judge who takes into account much broader values and norms, while deciding whether to enable an individual to go on with her planned transaction.

In a similar way, one could consider the goal setting theory as arguing the same position. Bandura claims that if a person chooses her own goals, she improves her chances of actually achieving those goals.<sup>116</sup> It is difficult to think of any legal tool that enables one to define one's goals more than a contract. While it is true that in a contract one can only attain goals that are agreed upon by the other party, contracts are still the best way to achieve this purpose. Along those lines, Deci<sup>117</sup> has reviewed a large amount of research regarding the psychological benefits of allowing individuals to make decisions about important areas of their lives. Nonetheless, it should be taken into account that currently, even in a regime of full freedom of contract, most contracts are negotiated by agents or lawyers. Consequently, major aspects of self commitment are lost when the parties themselves do not negotiate contracts. Moreover, even without state intervention, the parties' actual participation in the contracting process may be different than desired, due to the costs of framing, lack of knowledge and so on.<sup>118</sup>

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<sup>115</sup> Thomas Gilovich et al., *Commission, Omission, and Dissonance Reduction: Coping with Regret in the "Monty Hall" Problem*, 21 PERS. & SOC. PSYCHOL. BULL. 182 (1995).

<sup>116</sup> ALBERT BANDURA, *SOCIAL FOUNDATIONS OF THOUGHT AND ACTION: A SOCIAL COGNITIVE THEORY* 469 (Prentice-Hall 1986).

<sup>117</sup> Edward L. Deci & R. M. Ryan, *Self-Determination Theory: When Mind Mediates Behavior*, 1 J. MIND & BEHAV. 33 (1980); MYLES I. FRIEDMAN & GEORGE H. LACKEY, JR., *THE PSYCHOLOGY OF HUMAN CONTROL: A GENERAL THEORY OF PURPOSEFUL BEHAVIOR* (Praeger Publishers 1991).

<sup>118</sup> See Cass R. Sunstein, *Behavioral Economics and the Law of Labor*, available at [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=255993](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=255993) (last visited Oct. 11, 2002) (discussing the impact of information gaps and cognitive biases on the preferred options for employees).

### E. FREEDOM OF CONTRACT AND PROCEDURAL JUSTICE

The introduction to this paper states that there is a lack of normative treatment of civil law from the perspective of psychology. However, there are two exceptions to that claim: therapeutic jurisprudence<sup>119</sup> and procedural justice. These two schools of thought have much more in common than scholars working in these two areas are willing to admit. Both viewpoints advocate the psychological advantages of treating people in a certain way, both share a utilitarian view of the mental agency of law, and both treat control as a major policy concern for legal treatment.<sup>120</sup>

The literature of procedural justice usually positions the perception of fairness of a state policy as crucial to parties' ability to accept the outcome of that policy.<sup>121</sup> Monahan and Walker first introduced the theory of procedural justice<sup>122</sup> as part of their effort to determine more desirable procedures courts should employ in dispute resolution. Nevertheless, from that stage the theory has grown, mainly due to the work by Tyler, Greenberg and others,<sup>123</sup> and implications of procedural justice are discussed in many areas of legal policy. Two factors that may increase one's sense of procedural justice are having one's voice heard and having perceived control over the process. The theory does not suggest that a process could never be perceived as fair without allowing direct control over it, but it definitely recognizes control as a very important factor.<sup>124</sup> The use of this theory in connection with

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<sup>119</sup> For a review of the potential of this scholarship see DAVID B. WEXLER & BRUCE J. WINICK, *LAW IN A THERAPEUTIC KEY: DEVELOPMENTS IN THERAPEUTIC JURISPRUDENCE* (1996).

<sup>120</sup> For a discussion of the jurisprudential association of Therapeutic Jurisprudence, see Bruce J. Winick, *The Jurisprudence of Therapeutic Jurisprudence*, 3 PSYCHOL. PUB. POL'Y & L. 184 (1997).

<sup>121</sup> For a general overview of the relationship between procedural and distributive justice see, for example, TOM TYLER, *WHY PEOPLE OBEY THE LAW* (1990).

<sup>122</sup> JOHN W. THIBAUT, *PROCEDURAL JUSTICE: A PSYCHOLOGICAL ANALYSIS* (Lawrence Erlbaum Assoc. 1975).

<sup>123</sup> See *infra* notes 124-25.

<sup>124</sup> For a thorough description of the important role of participation and procedural justice among the various justice theories, see JERALD GREENBERG, *THE QUEST FOR JUSTICE ON THE JOB* 23 (Sage Publications 1995). More

contracts could suggest that the more voice and control people have over the act of contracts, the fairer the contracts will seem to them and the more connected they will feel to the outcomes. However, as mentioned in Part I, given the complexity of commercial life, it seems premature to say that if people gained more control in framing contracts, if the courts' interpretations were limited, and if every situation in our lives could be bargained, people would feel that they had more justice in their lives. In many cases where personal control over the contracting process was reduced, it was done in the name of protecting the presumed best interest of the weaker side. In other words, the context of the research on procedural justice does not allow us to assume that giving a person some control over future events will necessarily help that person understand the consequences of the contract she has signed.

Nevertheless, the most important point of the research on procedural justice is that the contracting process, which could be seen as a process which gives a voice to the personal desires of the parties involved, could help people see their contracts as fair, even if their personal view was not ultimately the controlling one.<sup>125</sup> Essentially, the lesson for contract theory from the procedural justice literature is that the process matters. Thus, good contract theory should be defined as not only successful in evaluating distributive justice-allocation risks efficiently, but also as providing incentives for the parties to fully commit to the contract.

#### ***i. Moderating Factors Between Control and Well-Being***

While it may be seen that the relationship between control and well-being is positive and linear, the true relationship is actually far more complex. To begin with, it is not even clear whether the desire for control is a universal motivation. A full understanding of what drives people has been the subject of decades of research by personality theorists as well as social

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specifically see K. Leung & W. K. Li, *Psychological Mechanisms of Process Control Effects*, 75 J. APPLIED PSYCHOL. 613 (1990).

<sup>125</sup> Tom R. Tyler, & Kathleen M. McGraw, *Ideology and the Interpretation of Personal Experience, Procedural Justice, and Political Quiescence*, 42 J. SOC. ISSUES 115 (1986).



psychologists.<sup>126</sup> The variability within those different schools of thought makes it hard to name one major force and present it as the one that most psychologists would favor. Nevertheless, the normative assumption made here is that the best interest of the parties in contract theory will be achieved through jurisprudence that can take into account the specific motivations people have when entering contracts. According to this approach, the legal mechanism created by the state should take into account the initial motivation of the person using it. Since the current jurisprudential regime offers no mechanism which takes into account people's preference for one regulatory mode over the other, the need to understand the costs of denying control is still justified.

The ambiguous role of control in self-motivation is illustrated by Higgins' analysis of the dual functions of the self.<sup>127</sup> Higgins developed a motivation theory that emphasizes the dual focuses of the regulatory process. In short, this theory takes a developmental approach, stating that some people grow up with an "ideal self-guide" which is aimed at promoting positive outcomes. Other people grow up with an "ought self-guide," which is focused on preventing negative outcomes. The result of these differences is that people treat the discrepancies or mismatches between their self-regulation mode and reality in different ways. While the ideal self-guide tends to approach mismatches, the "ought self-guide" tends to avoid them.<sup>128</sup>

A parallel paradigm<sup>129</sup> is posited by Atkinson and Feather, who distinguish between two types of people: success-oriented versus failure-threatened.<sup>130</sup> According to this theory, when some people face an important task they will focus on the glory stemming from possible success, while others focus on the shame

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<sup>126</sup> For a recent review see SELF AND MOTIVATION: EMERGING PSYCHOLOGICAL PERSPECTIVES (Abraham Tesser et al. eds., 2002).

<sup>127</sup> Tory Higgins, *Ideals, Thoughts, and Regulatory Focus*, in THE PSYCHOLOGY OF ACTION, *supra* note 98, at 91.

<sup>128</sup> For a graphic presentation of the psychological variables with distinct relations to promotion focus and prevention focus, see Tory E. Higgins et al., *Self-Regulation and Quality of Life: Emotional and Non-Emotional Life Experiences*, in WELL-BEING, *supra* note 91, at 244.

<sup>129</sup> *Id.* at 258.

<sup>130</sup> JOHN W. ATKINSON & NORMAN T. FEATHER, A THEORY OF ACHIEVEMENT MOTIVATION (Wiley 1966).

resulting from failure. The reasonable outcome of this analysis is that people with different cognitive approaches toward success/failure and avoid/approach would differ in their willingness to accept full control over their contracting.

Another paradigm, which suggests an additional moderator to the relationship between control and well-being, is the personal value theory of Schwartz.<sup>131</sup> Schwartz has developed a typology of universal values, which he uses mainly to examine the universality of the factors that are important for people in their lives.

The existence of such a dichotomy in motivation between these two forces raises an interesting perspective on the freedom of contract. It is plausible to assume, taking these differences into account, that some people's well-being is improved by having the complete freedom to pursue the best results on their own, and that others would react to this kind of freedom with fear, and would prefer for the state to take control on those issues.<sup>132</sup> Consequently, we can expect different responses to the question of whether any worker should be able to negotiate his terms on his own, or whether it is better to have the state do all the work, even if the mental benefits from the improved conditions will not be enjoyed directly by the worker.<sup>133</sup>

However, considering the above dichotomy, a major argument in favor of the freedom of contract can be seen as the following: part of the population, when choosing to contract, has revealed their preference for approaching the task on their own. The state's concern for these contracting parties' safety and losses<sup>134</sup> forces people in promotion mode to adopt a preventive

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<sup>131</sup> Shalom. H. Schwartz, *Universals in the Content and Structure of Values: Theoretical Advances and Empirical Tests in Twenty Countries*, in *ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY* 1 (M. Zanna ed., Academic Press 1992).

<sup>132</sup> As I will elucidate in the last section, it might be possible to distinguish between *situations* in which one motivational force will be more desired and *types of people*.

<sup>133</sup> Assuming that there is no guarantee who is going to do a better job, the state or the worker.

<sup>134</sup> For example, when refusing to enforce unfair terms.

mode, which, given the fact that they have chosen their own regulatory mode, would not have been their initial preference.<sup>135</sup>

## ii. *Individual Differences and the Benefit from Perceived Control*

Another type of moderating factor is due to individual differences in the desire for control.<sup>136</sup> Wegner and Bargh have reviewed several examples of this.<sup>137</sup> The list of differences is long (e.g. locus of control, self-efficacy) and the details of these individual differences are beyond the scope of this paper. However, the variability of those differences should be kept in mind when considering whether it is possible to suggest a normative treatment. Based on the described variability, Burger and Cooper have presented a specific scale of desirability for control.<sup>138</sup>

Similarly, Burger claims that some people are highly motivated to make decisions in relationships, to be leaders of groups, and to show their ability to conquer challenging tasks.<sup>139</sup> Likewise, Beckman and Kuhl<sup>140</sup> address the distinction between state- and action-oriented people. They find that the increased divergence between preferred and non-preferred options happens

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<sup>135</sup> This idea makes sense only if people choose to contract, meaning that they have an alternative. Part VI herein advocates a regime which would enable people to initially announce their preferences by choosing either a promotion mode, which would limit courts' intervention, or a safety mode, which would increase courts' intervention.

<sup>136</sup> Jerry M. Burger & Harris M. Cooper, *The Desirability of Control*, 3 MOTIVATION AND EMOTION 381 (1979).

<sup>137</sup> Daniel M. Wegner & John A. Bargh, *Control and Automaticity in Social Life*, in 1 THE HANDBOOK OF SOCIAL PSYCHOLOGY 446-96 (Daniel T. Gilbert et al. eds., 4th ed. McGraw-Hill 1998).

<sup>138</sup> Burger & Cooper, *supra* note 136.

<sup>139</sup> Jerry M. Burger, *Individual Differences in Control Motivation and Social Information Processing*, in CONTROL MOTIVATION AND SOCIAL COGNITION, *supra* note 94, at 203; see also JERRY M. BURGER, DESIRE FOR CONTROL 2-3 (Plenum 1989). For a description of the scale used by Burger and Cooper, *supra* note 136 at 11-17.

<sup>140</sup> Juergen Beckmann & Julius Kuhl, *Altering Information to Gain Action Control: Functional Aspects of Human Information Processing in Decision Making*, 18 J. RES. IN PERS. 224 (1984).

mainly with action-oriented subjects.<sup>141</sup> It is very likely that state-oriented people will prefer to avoid this painful process in a regime with complete freedom of contract, in favor of knowing that someone else (the state) has made the decision for them and that their interests are protected.

Seemingly, individual differences in relation to control and self-regulation could cause scholars to question the feasibility of developing a legal policy that would improve the well-being of the general population. Thus, the challenge might be to create a policy that would identify the situations in which those individual differences would not matter, or in which it would be possible to distinguish between people according to some predetermined preferences. Otherwise, the demand from the state to respect people's need for control could be easily, and to some extent justifiably, denied.

#### F. WOULD THERAPEUTIC JURISPRUDENCE SUPPORT GREATER CONTROL OVER THE CONTRACTING PROCESS?

The second discipline that has taken a normative approach to civil law from the perspective of psychology is therapeutic jurisprudence. Scholars in the therapeutic jurisprudence movement aim to see the law as a therapeutic agent, meaning that one of the purposes of the law should be a commitment to improving people's well-being.<sup>142</sup> Although the general idea is appealing, it is hard for

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<sup>141</sup> *Id.* 226-30.

<sup>142</sup> A thorough definition of the view of law by Therapeutic Jurisprudence can be found in Winick's introduction to his paper on jurisprudence. See Winick, *supra* note 120, at 185.

Therapeutic jurisprudence proposes the exploration of ways in which, consistent with principles of justice and other constitutional values, the knowledge, theories, and insights of the mental health and related disciplines can help shape the development of the law. Therapeutic jurisprudence builds on the insight that the law itself can be seen to function as a kind of therapist or therapeutic agent. Legal rules, legal procedures, and the roles of legal actors (such as lawyers and judges) constitute social forces that, whether intended or not, often produce therapeutic or anti therapeutic consequences. Therapeutic jurisprudence calls for the study of these

this author to accept that the law should be equally committed, across all of its doctrines, to people's mental well-being. Rather, every discipline within the law should receive distinct treatment, which takes into account the normative assumptions of the specific doctrines. Nevertheless, therapeutic jurisprudence has done much to illuminate the impact of the legal process on people's mental state, and is therefore relevant to this discussion.

In the mental health system, Winick claims that giving a patient the opportunity for informed consent and enabling her to become an active participant will improve her chances of success in treatment.<sup>143</sup> In other words, giving someone the opportunity to contract for medical care on her own terms is considered more beneficial for the patient. Hence, when people are self-determining, they function more effectively and with a higher degree of commitment.<sup>144</sup>

This suggests that the mental utility people acquire from the freedom of contract is not only limited to the outcome of the contract, but also to the process of entering it.<sup>145</sup> There is a connection with the thesis put forth in this paper regarding the mental impact of the process of contracting, and so this author agrees with the grand theory of therapeutic jurisprudence.

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consequences with the tools of the social sciences to identify them and to ascertain whether the law's anti therapeutic effects can be reduced, and its therapeutic effects enhanced, without subordinating due process and other justice values.

See also Elyn R. Saks, *Mental Health Law: Three Scholarly Traditions*, 74 S. CAL. L. REV. 295 (2000) (comparing the contributions of therapeutic jurisprudence to mental health law with the contributions of philosophical and doctrinal disciplines).

<sup>143</sup> BRUCE J. WINICK, *THE RIGHT TO REFUSE MENTAL HEALTH TREATMENT* (1997). The author advocates the freedom to choose treatment as a mentally beneficial procedure.

<sup>144</sup> BRUCE J. WINICK, *THERAPEUTIC JURISPRUDENCE APPLIED: ESSAYS ON MENTAL HEALTH LAW* (1997); David B. Wexler, *Therapeutic Jurisprudence and the Culture of Critique*, 10 J. CONTEMP. LEGAL ISSUES 263 (1999).

<sup>145</sup> It should also be recognized that the value of maintaining one's own motivational mode might not always be a replacement for the mental benefits of court protection. An empirical effort should be made to examine the value of the motivational mode to those people's well-being, when it makes them face the reality of a situation in which they are in fact exploited by someone who is smarter or who has a stronger bargaining position than they do.

Nonetheless, therapeutic jurisprudence may have a more limited impact than economics does on the way that doctrines are built. In short, therapeutic jurisprudence does not consider situational constraints, and therefore does not account for the uniqueness of every legal doctrine. On the whole, therapeutic jurisprudence treats the law as a tool that deals with different areas of life in some adaptive way. It cannot suggest what should be considered in each specific doctrine by taking into account the various characteristics of people's well-being. Thus, therapeutic jurisprudence is mainly concerned with the side effects of the law, and not with influencing its core doctrinal goals. The claim of this paper is that if the field of psychology wants to have a truly normative impact on legal policy making, scholars should determine what specific motivational forces should be achieved or acknowledged in each doctrine.

For example, accepting Schwartz' conflict between self-direction and security,<sup>146</sup> it seems plausible to assume that *contracts* would be more committed to promoting *self-direction*, and that *torts* would be more committed to promoting *safety*. Fulfillment of both needs could lead to beneficial therapeutic consequences. Nevertheless, torts and contracts are different doctrines which regulate different situations, and which have different policy purposes. In order for the field of psychology to have a normative impact, it must consider the norms of the specific doctrines and advise its perspective in consideration of those purposes. Consequently, this type of psychological jurisprudence would try to determine in the first stage whether a sense of control is actually good for people, depending upon the situation and the type of person involved. However, its major contribution would be to suggest the way in which the doctrine should be developed in order for it to enhance those motivational forces.

In comparison with the economic analysis of law, therapeutic jurisprudence could parallel a theory that states that the law should be conducted in a way that will make more money for more people. The economic perspective has done more than that, namely, defining each doctrine with its specific goals. This is the

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<sup>146</sup> See *supra* text accompanying note 131.

example that the field of psychology should follow if it wants to be applicable to legal theory.

Even if therapeutic aspects were the only considerations taken into account, it would probably not offer a unilateral solution to the spectrum of people's reactions to state intervention. Thus, even within the psychological perspective on the freedom of contract, the optimal solution in terms of psychological well-being does not necessarily support the position that more freedom and more control of the parties is psychologically preferred over state intervention; as will be shown, there are a few limitations to our 'pro-control' approach.

### III. IS CONTROL A GOOD THING FOR EVERYONE? POSSIBLE LIMITATIONS TO THE PSYCHOLOGICAL VALUE OF PERCEIVED CONTROL

Part I of this paper criticized the narrow perspective that behavioral economics has toward the relevance of psychological theory to public policy. By the same token, the powerful findings of cognitive psychology must be acknowledged, lest this author be guilty of the same fault attributed to Zamir. Kahneman and Tversky, in a very long list of collaborative research have questioned the rationality of people in the decision-making process.<sup>147</sup> According to their general findings, people do not have a very realistic approach to the world: they tend not to estimate risks correctly,<sup>148</sup> they do not accurately remember past experience, they do not possess an awareness of their faulty memories, and they can be easily manipulated.<sup>149</sup> This line of research has been continued by the work of Eldar Shafir, who has

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<sup>147</sup> Kahneman & Tversky, *supra* note 24; Daniel Kahneman & Amos Tversky, *On the Reality of Cognitive Illusions*, 103 PSYCHOL. REV. 582 (1996). There is also a growing interest in their work in the general legal literature.

<sup>148</sup> Amos Tversky, & Craig R. Fox, *Weighing Risk and Uncertainty*, 102 PSYCHOL. REV. 269 (1995).

<sup>149</sup> Lyle A. Brenner, Derek J Koehler, Varda Liberman, & Amos Tversky, *Overconfidence in Probability and Frequency Judgments: A Critical Examination*, 65 ORGANIZ. BEHAV. & HUMAN DECISION PROCESSES 212 (1996).

improved the description of the cognitive process involved in these biases.<sup>150</sup>

In Zamir's paper on paternalism, he uses the findings of Kahneman and Tversky to advocate a reduction in the freedom of contract.<sup>151</sup> According to his argument, given the limited ability of people to estimate risks and make fully rational decisions there is a need to question the amount of freedom the state should give parties to a contract.<sup>152</sup> The rationale used by this tradition is very simple: the more flaws one can find in the way people make their decisions, the greater the moral and economic justification for the state to interfere with self-governance among individuals.

Aside from the "biases literature," social psychology as a whole presents a picture in which the ability of people to accurately see reality is very low. People are subject to influences they are not always aware of, and they might like things for reasons they cannot always explain. They perceive reality according to many irrelevant factors, and their knowledge about their environment is limited, due to the complexity of the human mind. Therefore, the state should focus not on how to give people more control but on how to protect people from themselves.<sup>153</sup>

#### A. REGRET AVERSION

Negative emotions related to a sense of control are common in certain situations, and can limit one's ability to take control in decision making.<sup>154</sup> Some psychological research that has been conducted in the area of decision analysis suggests that

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<sup>150</sup> Eldar Shafir & Amos Tversky, *Thinking Through Uncertainty: Nonconsequential Reasoning and Choice*, 24 COGNITIVE PSYCHOL. 449 (1992); Eldar Shafir & Amos Tversky, *Decision Making*, in 3 THINKING: AN INVITATION TO COGNITIVE SCIENCE 77 (Edward E. Smith & Daniel N. Osherson eds., 2d ed. MIT Press 1995).

<sup>151</sup> See Zamir, *supra* note 16.

<sup>152</sup> For elaboration on the various cognitive biases and their implication for law, see *supra* notes 4-5, which include recent papers on this subject matter.

<sup>153</sup> While this paper is attempting to show that this view cannot be seen as the sole representative of the role psychology can play in the field of law, the powerful findings in this line of research makes it too important to ignore.

<sup>154</sup> Jerry M. Burger et al., *Boundaries of Self-Control: Relinquishing Control Over Aversive Events*, 8 J. SOC. & CLINICAL PSYCHOL. 209 (1989).



people who might be faced with feelings of regret will either prefer not to take any steps, or to take steps with fewer expected risks.<sup>155</sup> Recently, Korobkin conducted empirical research based on the theory of regret aversion in decision making.<sup>156</sup> He found that people prefer to accept the default rules to their own negotiated terms when they are not sure enough about the consequences of their actions.

In a paper using a similar paradigm, Guthrie explores the role of emotions in litigation decisions, suggesting again the possibility that people might choose sub-optimal solutions in order to avoid feelings of regret.<sup>157</sup> Thus, we can see that control is not desired by all people, and in some situations, most people would prefer to have no personal control in contracts.

#### **B. THE NEGATIVE IMPACT OF PERCEIVED CONTROL ON WELL-BEING**

Much of the research on control in social psychology has been focused on the psychological effects of a sense of control, as opposed to actual control. Some question the rationale behind the assumption that a sense of control is always a good thing, arguing that a sense of control could be more of a culturally-based phenomenon than a self-driven mechanism.<sup>158</sup> Nevertheless, since the theory emerged from research in learning theory in animals,<sup>159</sup> one could question the validity of the cultural effect argument.

Some researchers have pinpointed perceived control as being responsible for the occurrence of counterfactual thought;<sup>160</sup>

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<sup>155</sup> Richard P. Latrick, *Motivational Factors in Decision Theories: The Role of Self-Protection*, PSYCHOL. BULL. 113, 440 (1993).

<sup>156</sup> Russell Korobkin, *Inertia and Preference in Contract Negotiation: The Psychological Power of Default Rules and Form Terms*, 51 VAND. L. REV. 1583 (1998).

<sup>157</sup> Chris Guthrie, *Better Settle Than Sorry: The Regret Aversion Theory of Litigation Behavior*, 1999 U. ILL. L. REV. 43.

<sup>158</sup> Wegner & Bargh, *supra* note 137.

<sup>159</sup> Robert White, *Motivation Reconsidered: The Concept of Competence*, 66 PSYCHOL. REV. 297 (1959).

<sup>160</sup> Keith D. Markman et al., *The Impact of Perceived Control on the Impregnation of Better and Worse Possible Worlds*, 21 PERS. & SOC. PSYCHOL. BULL. 588 (1995).

in other words, the greater a person's sense of control in a given decision, the greater the chances that she will have counterfactual thoughts regarding this decision. Burger claims that when there are potentially negative outcomes, people will give control to others, preferring to reduce their sense of own control in order to diminish the counterfactual thinking connected to it.<sup>161</sup>

Burger names three circumstances in which increased perceived control might lead to negative responses. This is likely to happen, first, when the increase in perceived control leads to a high level of concern for self-presentation; second, when a person perceives a decreased probability of obtaining a desired outcome; and third, when the increased perceived control increases the attention paid to unpredictable events.<sup>162</sup> In any case in which there are variables that might lead to poor outcomes, people will experience anxiety stemming from feelings of responsibility for the results. Taking this data into account raises serious questions concerning the promotion of control in the freedom of contract. Because most contract circumstances are accompanied by the potential for disappointment along with some probability of undesirable outcomes, this knowledge might suggest that regulations set by the state might often increase people's well-being.

In a related perspective, which again questions the overall value of perceived control, Miller has developed the idea of the "minimax hypothesis." According to this hypothesis, "individuals want to minimize the maximum danger to themselves, that is, they are inclined to make the best of a bad situation."<sup>163</sup> According to Miller, when people tend to believe that their skill at a given task is inferior to that of the person with whom they are performing the task, they tend to give up control.<sup>164</sup> Dolinski also discusses life

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<sup>161</sup> Jerry M. Burger, *Negative Reactions to Increases in Perceived Personal Control*, 56 J. PERS. & SOC. PSYCHOL. 246 (1989).

<sup>162</sup> *Id.*

<sup>163</sup> Susan M. Miller, *Why Having Control Reduces Stress: If I Can Stop the Roller Coaster, I Don't Want to Get Off*, in HUMAN HELPLESSNESS: THEORY AND APPLICATIONS 71, 80 (Judy Garber & Martin E. P. Seligman eds., Academic Press 1980).

<sup>164</sup> In our case, the partner is the state, which is, presumably, sometimes a better partner and sometimes worse.

circumstances in which personal control seems less attractive.<sup>165</sup> In contrast with the above-mentioned hypothesis, he offers the “maximax hypothesis,” theorizing, in short, that as people assume they can achieve better outcomes, they will tend to maintain their control in a situation.<sup>166</sup>

Peterson claims, based on Fromm’s famous book *Escape From Freedom*,<sup>167</sup> that although a sense of control has, generally speaking, a good influence on people’s well-being, it is definitely not a prerequisite.<sup>168</sup> According to him, it seems plausible that in many cases, the value of perceived control is overestimated.<sup>169</sup>

**C. THE DISTINCTION BETWEEN FREEDOM TO BARGAIN AND FREEDOM TO ENFORCE: IS CONTROL A NEED FOR AUTONOMY OR A NEED FOR POWER?**

The underlying assumption dominating the first part of this paper took for granted the idea that more freedom and less state intervention means more personal control. It is important to mention that the concept of control can be applied to different courses of action, and hence will lead to different conclusions, such as the desired solution for the contracting parties. Control in this case is related to the need for power. Here, the intervention of courts, even when in people’s best interests, might actually serve people’s need for power.

Therefore, once the regulations that limit contracts are reduced, and legal presumptions are created in favor of weaker parties, these parties could participate in the contracting process in much broader areas, knowing that they can always be assured of court assistance. In this way, the use of doctrines such as unconscionability could be seen as a weapon in the hands of a weaker party when negotiating her contract. In this context, it is

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<sup>165</sup> Dariusz Dolinski, *To Control or Not to Control*, in PERSONAL CONTROL IN ACTION *supra* note 96, at 319.

<sup>166</sup> *Id.* at 319.

<sup>167</sup> ERIC FROMM, *ESCAPE FROM FREEDOM* (Rinehart 1941).

<sup>168</sup> Christopher Peterson, *Personal Control and Well-Being*, in WELL-BEING, *supra* note 91, at 288.

<sup>169</sup> *Id.* at 289.

interesting to think of the following views about why people need control.

According to Adler, a desire for control translating into a desire for power does not necessarily favor freedom of contract.<sup>170</sup> From this perspective, one way to preserve control is to replace the action of negotiating with the action of litigating.<sup>171</sup> On the other hand, associating the need for control with the need for autonomy tends to lead to the opposite view. Murray might see the intervention of the state as less desirable even if such intervention might empower the weaker parties and serve their interests in a better way.<sup>172</sup>

#### IV. SYNTHESIS AND APPLICATION: FRAMEWORK FOR FUTURE RESEARCH

##### A. FACTORS FOR CONSIDERATION

##### i. *Hot Biases vs. Cold Biases*

The line of thought advocated by Shelley Taylor<sup>173</sup> (Taylor and Brown,<sup>174</sup> Weinstein<sup>175</sup>) concerns the importance of positive illusions and false attributions.<sup>176</sup> According to this line of

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<sup>170</sup> ALFRED ADLER, UNDERSTANDING HUMAN NATURE. (W. Beran Wolfe, trans., Fawcett 1961) (1927).

<sup>171</sup> A comment might be needed here for the non-lawyer reader: In a regime where there is complete freedom of contract, there are fewer situations in which the person could actually litigate against the enforcement of the contract, since the initial acceptance of the terms of the contract is the most important factor.

<sup>172</sup> HENRY A. MURRAY, EXPLORATIONS IN PERSONALITY (Oxford University Press 1938).

<sup>173</sup> See Shelly E. Taylor & Jonathon D. Brown, *Positive Illusions and Well-Being Revisited: Separating Fact from Fiction*, 116 PSYCHOL. BULL. 21 (1994); see also Shelley E. Taylor et al., *Psychological Resources, Positive Illusions, and Health*, 55 AM. PSYCHOL. 99 (2000); Shelly E. Taylor & David A. Armor, *Positive Illusions and Coping with Adversity*, 64 J. PERS. 873 (1996).

<sup>174</sup> Shelly E. Taylor & Jonathan D. Brown, *Illusion and Well-Being: A Social Psychological Perspective on Mental Health*, 103 PSYCHOL. BULL. 193 (1988).

<sup>175</sup> Neil D. Weinstein, *Unrealistic Optimism About Future Life Events*, 39 J. PERSON. & SOC. PSYCHOL. 806 (1980).

<sup>176</sup> Edward E. Jones & Keith E. Davis, *From Acts to Dispositions: The Attribution Process in Person Perception*, in 2 ADVANCES IN EXPERIMENTAL SOCIAL PSYCHOLOGY 219 (L. Berkowitz ed., Academic Press 1965).

reasoning by Taylor and others, it is perhaps time to rethink Zamir's and Eisenberg's ideas on the legitimacy of state intervention when there are motivationally based biases at work.

In examining the justification for limiting the freedom of contract, there should be a distinction made between inadequate information processing capabilities, known as cold biases, and inadequacies which are motivationally driven, known as hot biases. It seems reasonable for the state to take a paternalistic position if it takes into account the limits of individuals' cognitive abilities. People should be responsible for their own lives, as long as they are capable of doing so. In situations in which an individual is unable to manage her own life, the state does not actually replace the judgment of the individual, it improves it.

However, when dealing with motivationally driven biases, the intervention of the state to correct these kinds of biases might force people to think of events and possibilities from which they want to protect themselves. In the hot biases context, people mistake reality for some motivational value. The fact that these decisions are not made with full awareness, and that they are faulty, is not enough to undermine the adaptive value of those biases. In other words, in contrast with cognitively based biases, which are based on the limits of people's abilities, the major purpose of motivational biases is to protect the self. This is not to say that the state's intervention should be completely forbidden in all cases, even when severe harm could occur. Rather, the author believes that the emerging literature, which calls for limiting the freedom of contract, should recognize the positive value of some of the aforementioned "hot" biases. Obviously, mistakes carry consequences, which could legitimately justify the state's intervention. However, some of those mistakes have emotional value, and correcting them might harm the important need of individuals to perceive reality in an accurate way.

## ***ii. Controllability and Predictability***

In order to maximize control over their lives, individuals need to take steps that will increase the predictability of future life

events.<sup>177</sup> Kelly has emphasized the importance of predictability in creating a sense of control over the events of one's own life.<sup>178</sup> A legal regime in which freedom of contract is enforced is ideal for serving this purpose, since the state's only consideration, when asked to intervene, is what the parties wished to have in their contracts. In this situation a person bargains for what she wants done, with very few obstacles along the way. A regime in which the court takes into account considerations other than the original intent of the parties necessarily adds a growing amount of unpredictability to one's life, and so reduces one's feeling of control. Since it is recognized that court intervention in contract terms and interpretations is sometimes unavoidable, we should examine, from the perspective of an individual's well-being, how damage from this kind of intervention could be reduced.

The optimal way to take into account people's need for the predictability of events, and hence for the avoidance of harmful situations, is to create a clear policy to be announced ex-ante. An unambiguous policy, from a psychological perspective, is one that defines very clearly, at the legislative level, unenforceable conditions. Hence, according to Zamir's theory, modern contract law does not promote the intentions of the parties but rather incorporates values of fairness, cooperation and equality into people's interactions.<sup>179</sup> Naturally, standards such as good faith and public policy, as well as the recently added "bounded rationality" line of arguments, reduce the controllability of the process by the parties, since they make it difficult for the parties to actually understand from the code itself whether the contract will be enforced, and to what extent their words and actions really matter. The debate on rules versus standards cannot be decided based only on individual mental perspectives. Yet the well-being perspective of predictability should receive a great deal of recognition in the set of arguments involved.<sup>180</sup>

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<sup>177</sup> FRIEDMAN & LACKEY, *supra* note 117, at 57.

<sup>178</sup> GEORGE A. KELLY, *THE PSYCHOLOGY OF PERSONAL CONSTRUCTS* (Norton 1955).

<sup>179</sup> See Zamir, *supra* note 16.

<sup>180</sup> It should be mentioned that economic scholars present a similar criticism of the unpredictability of courts.

### iii. *Rhetoric of the Courts*

Another implication for the well-being approach to the freedom of contract is connected with the rhetoric of the courts. It has been suggested that courts are talking to two different audiences in two different voices: the legal community and the general public.<sup>181</sup> It seems that most people still think that they have more legal power in their contracts than they do. This assumption needs empirical proof, but this author believes that the view of the average person is that individuals retain ownership of contracts. Obviously, if a person possessing this fallacious belief were to enter a contract and then feel that she was abused by the contract, she would ask a lawyer for the protection of the court. However, courts should not try to disabuse people of this notion by specifically stating in their judgments that parties' intentions are only one out of many factors considered in contract interpretation. Given some people's need for control, it might be wise to advise the courts to try to reduce the threat against control in their rhetoric. Drawing from the procedural justice perspective,<sup>182</sup> courts should pay greater attention to the way the litigants perceive the court's active role in treating contracts. This is not to suggest that sole purpose of the courts should be to improve the psychological well-being of the parties. Clearly, the courts' rhetoric should take into account other factors as well. Yet, due to the importance of perceived control for the parties in their coping abilities, and due to the promotion motivations people reveal when choosing to contract, the courts' careful use of language could be a less costly and more effective way of helping to preserve parties' sense of control.<sup>183</sup> Signaling to people that the court will always protect their interests, while giving limited attention to the actual terms of the contract, might decrease ex-ante the parties' perception of the contracting process.

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<sup>181</sup> Meir Dan-Cohen, *Listeners and Eavesdroppers: Substantive Legal Theory and Its Audience*, 63 U. COLO. L. REV. 569 (1992).

<sup>182</sup> Tom R. Tyler, *What is Procedural Justice?: Criteria Used by Citizens to Assess the Fairness of Legal Procedures*, 22 LAW & SOC'Y REV. 103 (1988); Tom R. Tyler, *Client Perceptions of Litigation; What Counts: Process or Result?*, TRIAL, July, 1988 at 40.

<sup>183</sup> See Albert Bandura, *Self-Efficacy Mechanism in Human Agency*, 37 AM. PSYCHOL. 122 (1982); see also BANDURA, *supra* note 116.

## B. CREATING A DIFFERENTIATED APPROACH TO FREEDOM OF CONTRACT

A potential suggestion emerging from this paper is for a legal policy maker to create different routes for contractual relations. A major distinction would be the amount of autonomy people want to have in their contracts. People should be given the option in advance to enter a contract in which the courts have limited access.<sup>184</sup> The courts should be aware that when they face a contract in which their possible intervention has been “contracted away,” they must honor this restriction in order to avoid harming people’s preference for control motivation, as long as this initial choice seem reasonable.<sup>185</sup> Moreover, in this case people with different desires for control could reveal their preferences and signal other parties to the contract about their motivational interests. The same goal could be achieved by making pre-regulated default contracts available in more areas than they are today, so that people who prefer to negotiate and not to accept the state’s suggestions for managing their relations will again be able to reveal their preferences for self-control. In the current regime, people sometimes contract because there is no other choice, not because they want to. Therefore, when they choose to contract their preferences cannot be revealed. However, in cases in which people do choose the safer route under high protection of the courts, they could still preserve their sense of control on some level. Thus, employees or consumers could feel that their personal control has been relinquished voluntarily, and not because they are considered by courts as cognitively unfit to regulate their own contracts due to their limited personal and economic power.<sup>186</sup>

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<sup>184</sup> It should be mentioned that in practice those things already exist; for example, people can agree in the contract that in case of disagreement they will go to an agreed arbitrator; in most cases courts will respect this kind of agreement and will avoid intervention.

<sup>185</sup> Thus, the courts should scrutinize the initial choice, but once they have chosen this option, courts should take a more conservative approach.

<sup>186</sup> There are obvious criticisms based on information problems and unequal bargaining positions that could lead to the opposite conclusion; as mentioned before, the purpose of the paper is to suggest the motivational aspect as a factor to be considered, although I do realize that it might ultimately be denied.



An additional distinction could be made between form and bargained contracts. Obviously, even according to classical theory, courts are more suspicious of form contracts than bargained contracts. However, the rationale for that policy is that the party who did not frame the form contract lacked information. According to the analysis in this paper, active intervention of the courts is more justified in form contracts because such intervention does not jeopardize the parties' sense of control; it seems safe to assume that changing the original intention of people engaging in form contracts is less harmful to their sense of control than it would be in bargained contracts.

### **C. DIFFERENTIATED LEVELS OF ACTIVISM OF COURTS WHEN ENFORCING CONTRACTS**

A second proposal would take into account social differences, which are related to individual differences in the desire for control. In this view, courts should be aware of which types of people are most likely to prefer more control over their contracts and vice versa. The advantage of considering social differences (as opposed to individual differences) is that they are easier to control at the level of policy making. For example, if we take into account age as an influential factor in the amount of control people prefer, policy makers might treat the transactions of elderly people differently than the same transactions performed by younger people. In other words, if psychological knowledge can tell us that young people place a higher value on the desire for control than elderly people, courts could have an additional factor to consider when interpreting and enforcing contracts. In the instance of younger people coming before the court, the court would need to know that the cost for the sense of control to these people is likely to be higher than in the case of older people. This is not to say that courts should not scrutinize young people's contracts. However, there is no reason that this factor could not serve as an important consideration in the courts' decisions concerning whether to intervene in the original contract.

It should be mentioned that economic analyses of law do take into account people's age (or business cycle) when considering the amount of caution the courts should take when

interpreting the at-will clause in an employment contract.<sup>187</sup> Similarly, if the harm to people's motivation varies among certain groups of the population, that could be identified ex-ante by the parties themselves, and courts could uphold their interventions to some extent. Thus, today when courts face a less educated person, they usually tend to assume that they need to use more doctrines such as unconscionability than when dealing with a highly educated person. The rationale used by courts for this distinction is the assumed bargaining position of this person. The suggested approach calls the attention of the court to a different factor: how likely is a person to be harmed if she (or similar people) is treated as someone without the ability to control her contract? Similarly, the state, when deciding whether to allow various types of transactions to be controlled by bargained contracts or state regulations, should consider what types of people are most likely to engage in these transactions, and what their assumed preferences are toward having a sense of control over their contracts.

Unfortunately, in this case, the theory exceeds the data, since most social factors such as age, education and gender are not actually very influential, at least in relation to the desire for control. In fact, Burger claims that, by and large, there are very slight differences in age with respect to the desire for control; more differences exist between genders, although this phenomenon, which is considered to be cultural, is undergoing change.<sup>188</sup> Education also has some impact, though again, it is very possible that some of the change could be explained through the existence of confounding variables.<sup>189</sup> The only major social difference that has a significant effect is culture,<sup>190</sup> which could lead to some effects on international contracting between cultures with different levels of desire for control.

Any effort to advocate a jurisprudence of mental well-being should be, according to the above-mentioned analysis, sensitive to these demographic moderators. Thus, for example, we could

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<sup>187</sup> See Ayres and Schwab, *supra* note 89.

<sup>188</sup> See JERRY M. BURGER, *Desire For Control: Personality, Social, and Clinical Perspectives* (1992).

<sup>189</sup> *Id.* at 32-34.

<sup>190</sup> John R Weisz et al., *Standing Out and Standing In: The Psychology of Control in America and Japan*, 39 AM. PSYCHOL. 955 (1984).

assume that a lower-educated worker might like the idea that the state bargains for her rights, and so care less about the fact that she is not the one who actually negotiates her rights. The same fact might be more disturbing to someone who does not think that the state is more likely to do better for her than she could do for herself. The current situation does not place much importance on people's personalities. The current rules give no attention to actual people but rather to the type of law (e.g. consumer or employment versus business law). Therefore, different people do not have the opportunity to reveal their preferences if they happen to be in situations which do not match their preferences (e.g. a consumer who wants control of a transaction, or a businessman who does not want control of a situation). Additionally, it could be argued that people themselves may not be sure whether they want control in a given situation, and so their own ex-ante preferences may not reveal much about what they would want the courts to do.<sup>191</sup>

#### ***i. Long-Term Contracts vs. Short-Term Contracts***

This paper has presented several theories that focus on the influences of a person's social skills, especially when discussing the advantages of choice. Moreover, it has addressed the concept of increasing commitment and self-efficacy as related to personal autonomy in the nature of contracts. However, it is important to note that almost all of these predictable psychological benefits are much more salient when talking about long-term contracts<sup>192</sup> than when discussing short-term contracts. In most short-term transactions, there are no ongoing relations between the two parties, and concepts such as commitment, coping ability and the like are not necessarily required for an efficient transaction. Furthermore, it seems that in short-term contracts, the disadvantages of having control in the situation (regret aversion, counterfactual thinking) are even greater than in long-term contracts, since the outcomes are usually more quickly realized

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<sup>191</sup> This argument again reveals the problem psychology has when dealing with normative law, which the field of economics, due to the simplicity of its assumptions about human behavior, is spared.

<sup>192</sup> By long-term contracts I also mean relational contracts.

(e.g. buying a damaged product, contracting away the manufacturer liability).

This dichotomy suggests that, if accepting the relevancy of psychological factors in contract policy, we might want to consider different levels of freedom in these two types of contracts. Thus the motivational-based theory of contracts could lead us to create specifications in the applicability of contract principles, which might seem meaningless without them. No other paradigm of freedom of contract would take into account what kinds of relations a specific contract tries to promote. Only when the mental implication of free choice is considered is there a point in trying to examine the possible need for control in these relationships. In most short-term contracts, there are fewer opportunities for the positive impact of absolute free choice.

As a result, if transaction costs force the use of form contracts instead of bargained contracts, from a psychological perspective it is better to use them in transaction contracts and not in long-term contracts. Assuming that there are more transaction contracts than long-term contracts, the transaction costs saved by form contracts in the first category are much greater, making them less beneficial from a psychological standpoint. However, when using form contracts in relationships where the need to respect the contract is continuous, the advantages of bargaining on commitment and one's ability to cope with difficulties become essential.

## ii. *Permanent vs. Temporary Weaknesses*

The paradigm herein presented views the intervention of courts in the management of a contract as a threat to people's feelings of personal control, self-efficacy, and their preferred regulatory mode. This perception would suggest the following approach: When facing a situation in which the party protected by court intervention is internally weak due to her social role, courts should take more precautions than when facing a party whose weakness is due to occasional circumstances.

To simplify this dichotomy, let us assume that two different people are about to learn of a court's decision to ignore their original term because they had made mistakes about the risk

involved in the contract. The first party is a consumer, whose contracts by and large are protected by legal policy, and much of her autonomy is taken away by all the consumer regulations and limits the law puts on the manufacturer. Nevertheless, since being a consumer is not a pure “social role” in one’s life, and since everyone in every class and economic level is a consumer at one time or another, the threat to the person’s self through her lack of perceived control is not of grave importance. On the other hand, the law has been very protective in its approach to workers’ ability to contract on their labor terms. Being a worker (who is not at the level of personal contracts) is a permanent social role in one’s life. In many cases it is attached to one’s social class and lack of economic power. (In fact, the reasons behind those limits on contracting are due to the economic necessity of the worker, as opposed to the consumer, who usually lacks all information but doesn’t belong, on average, to lower classes) In the employee’s case, the inability of the individual to manage her industrial relations might create a bigger threat to her self-perception than in the consumer’s case, because the consumer’s “weakness” is not part of her social identity. Economic theorists of contracts, who ignore the mental implications of limited freedom of contract, could not see any reason to differentiate between employee and consumer. Psychologists, however, should advocate a broader view of what factors should be taken into account in order to justify state limitations on individuals’ freedom to contract.

## V. CONCLUSION

This paper has tried to achieve two objectives. First, it has attempted to show that broader areas of psychology than those thought relevant by behavioral economics should be part of legal theories such as freedom of contract by demonstrating the larger claim that there is a need for the field of psychology to approach the themes behind legal doctrines if it wants to be more influential in legal matters. Second, the author suggests that another factor should be taken into account in contract theory: the freedom of the individual from the states’ paternalism.

According to this approach, the decision as to which areas should be under contract regime and which should fall under

regulation regime, and the level of courts' intervention in the original intention of contracting parties, could be informed, at least in part, by different aspects of social psychology. More specifically, although psychology is a field that has a much more complex perspective of people than economics, it can still offer a unique point of view in jurisprudentially relevant questions. Making the legislator, as well as the courts, more informed about the psychological point of view might create much more adaptive legal systems. The ability to contract has a strong connection with a variety of psychological factors such as motivation, commitment, self-efficacy, mental representation and self-related mechanisms. Understanding them and knowing their pros and cons should play an important role in any contract policy argument which examines the scope of limitations on parties' ability to bargain on their contracts. Such awareness could preserve the ability of contracts to serve both as a therapeutic tool and a better economic tool. That is, improving people's sense of control is not only justified under a simple utilitarian view of maximizing well-being, it is also more efficient under neo-classic definitions of optimal contractual behavior. Given the broad subject of this paper, the analysis is far from inclusive on all relevant normative and empirical questions. In a sense, this paper could be read as an agenda for the kind of research law and psychology scholars could take in normative approaches to law. Additional analytical and empirical work is needed to focus on the role psychology could fill in multi-dimensional policy questions such as the one posed in this paper. The new interest of psychology and economics scholars in measuring and understanding the factors responsible for well-being, as well as recent developments in therapeutic jurisprudence could and should be applicable to the normative concerns of contract theory.