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Ghosh Norm Creation

# WHERE'S THE SENSE IN *HILL V. GATEWAY 2000*? REFLECTIONS ON THE VISIBLE HAND OF NORM CREATION

Shubha Ghosh<sup>1</sup>

## I. INTRODUCTORY BACKGROUND ON THE THEORY OF NORMS

If an economist were asked what it means for something to be commonsensical, her answer may appeal to some notion of what is rational. A commonsensical act is one that a rational person would do. But what is rational will often depend upon the context against which decisions are made and judged.<sup>2</sup> Rationality does not exist in a vacuum. What is commonsensical, what is rational will depend upon the host of legal institutions within which actors, whether consumers or merchants or judges, perform. How do economists understand legal institutions? My analysis of Judge Easterbrook's decision in *Hill v. Gateway 2000*<sup>3</sup> illustrates an emerging focus on law and economic analysis of legal institutions: the theory of norms and norm creation.<sup>4</sup>

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<sup>2</sup> See Richard E. Redding, *How Common-Sense Psychology Can Inform Law and Psycholegal Research*, 5 U. CHI. L. SCH. ROUNDTABLE 107, 137-42 (1998) (laying out a model for common-sense psychology as applied to the study of legal institutions).

<sup>3</sup> 105 F.3d 1147 (7th Cir. 1997).

<sup>4</sup> See generally *Symposium: Law, Economics & Norms* 144 U. PA. L. REV. 1643-2339 (1996), see also *Symposium: The Nature and Sources, Formal and Informal, of Law*, 82 CORNELL L. REV. 947-1242 (1997) (providing an overview of this developing literature).

Traditionally, economists analyzing legal institutions have focused on two principal mechanisms through which law functions: a centralized command mechanism and a decentralized property rights mechanism.<sup>5</sup>

The command mechanism is what many non-experts in law and economics might immediately associate with the purpose of law. If the legislature, for example, decides that automobiles should move at fifty-five miles per hour and no more, the legislature passes a statute commanding such an outcome with the appropriate sanction if violators are caught. From an economic perspective, what the legislature is doing is placing a price on speeding. Those who are willing to speed will do so if they are willing to pay the price associated with the sanction, appropriately discounted for the probability of getting caught. The price of speeding will also affect the types of evasive measures that potential speeders would take. For example, a radar detector could reduce the probability of getting caught while speeding and hence reduce the price of speeding. A potential speeder would only buy the detector if its price were less than or equal to the reduction in the price of speeding. A command mechanism is a centralized one; its contours are defined by the legislature. A command mechanism also operates like a tax, affecting the price of undertaking the regulated conduct.

A property rights mechanism is a less intuitively obvious method by which law functions. Under a property rights mechanism, a statute or a judicial decision creates a rule which is designed to define a right held by an individual or a group. The rule defines a right in two ways. First, the rule determines what the individual holding the right is entitled to do or refrain from doing. Second, the rule defines what the remedy is if the right is infringed upon by someone else. The structure of a property rights mechanism can be complicated. A property rights

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<sup>5</sup> See, ROBERT ELLICKSON, ORDER WITHOUT LAW 2-4 (1991) (discussing Coase's property rights approach to dispute resolution); see also Robert Cooter, *Normative Failure Theory of Law*, 82 CORNELL L. REV. 947, 950-53 (1997) (discussing centralization and decentralization in law making).

mechanism protects two rights: the right of drivers to speed and the right of other people to be compensated for accidents that result from speeding. In the example of preventing speeding, the rule under a property rights mechanism could be structured as follows: all drivers have the right to go as fast as they want, but a driver who causes an accident because of his speeding is liable for the resulting damages to the injured party. Such a rule would have some effect on the behavior of drivers; whether it results in less speeding or more is an empirical question which will depend upon, (a) how individual drivers respond to the rule, and (b) how in the aggregate the drivers' individual decisions would interact.

There are some very salient distinctions between the command mechanism and the property rights mechanism. The property rights mechanism does not require a definition of speeding *ex ante*, while the command mechanism does. Instead, the determination of what constitutes 'speeding' occurs after an accident has occurred and takes place either in a court of law or through some form of alternative dispute resolution. Furthermore, enforcement is party-driven under a property rights mechanism, while a command mechanism requires centralized authority to police individual behavior. For these two reasons, a property rights mechanism is a decentralized mechanism, while a command mechanism is a centralized one.

The two mechanisms, however, suffer from several common deficiencies. Both require extensive information gathering to be effective. The command mechanism requires extensive information about the conduct to be regulated in order to set out the rule and the sanction *ex ante*. The property rights mechanism also requires extensive information although it would be collected by parties after an accident occurs. The information costs make each approach potentially difficult to implement. However, even if the information costs were low, both mechanisms also lack a degree of realism to make them effective or palatable. In the example of speeding that I have been discussing, it may very well be the case that a person chooses not to speed because an internal conscience says not to speed. Alternatively, a person may speed because regardless of the price of speeding or the likelihood of an accident, speeding is socially

accepted and going slow is frowned upon. Individual conduct may be driven by these internal and external forces, and the role of law is irrelevant from the perspective of either commanding a result or defining a right. People behave not in the shadow of the law, but outside its penumbra. Human behavior and human law are independent.

Recently, many law and economic scholars have recognized the importance of conscience and social forces in dictating human behavior and the role of the law. This recognition stems in part from the limits of the command and the property rights mechanisms discussed here. Another impetus is increased dissatisfaction with the rational actor model that both these mechanisms presume. Individual rationality, the notion that humans act based on the cost-benefit calculations, cannot explain social problems that stem from addictive behavior or explain such phenomena as voting, political campaigning, or the use of the courts to assure civil liberties. Conscience and social forces need to be appealed to in order to better understand observed conduct. Furthermore, individual rationality often can justify what many may describe as social pathology, a reluctance to change the status quo or to organize in groups and form human societies.

Hence, law and economics scholars have turned to the study of norms. A norm is an informal rule that dictates when a person is obligated to act or not to act in a certain way. The doffing of hats in a church, to take an example from Professor Robert Cooter, is a norm.<sup>6</sup> Even if a man is inclined to keep the hat on in the church (for example, because the temperature in the church is too low), a man still removes the hat because society dictates.<sup>7</sup> A norm may be so internalized that one's conscience automatically responds causing the individual to feel guilty if the norm is not followed. Norms serve as a mechanism, in addition to that of command and property rights, to shape conduct.

In the context of speeding, lawmakers can control speeding by promoting the norm of good and safe driving, for example, by showing that they take safe driving seriously through deliberating its virtues and passing a law that punishes speeding.

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<sup>6</sup> Cooter, *supra* note 5, at 954.

<sup>7</sup> Cooter, *supra* note 5, at 953-54.

The force of the law is not in affecting the price of speeding or in defining rights, but in symbolically communicating to the public that speeding should be avoided.

This capsule summary of the various mechanisms by which law functions, as analyzed by economists, serves as background for the focus of this paper, my contribution to the symposium on *Hill v. Gateway 2000*.<sup>8</sup> As I explain in detail in Section Two, Judge Easterbrook's appeal to "sense" is an appeal to norms. What the Judge is doing is seeding or creating a norm that will govern individual conduct in contractual transactions. He is not commanding a result or even defining property rights. Instead, he is symbolically communicating what the norm should be for consumers when they purchase items over the phone. More broadly, given his reliance on *ProCD v. Zeidenberg*,<sup>9</sup> a prior decision authored by Judge Easterbrook, the Judge is seeding a norm for property definition over databases and other new technologies. The sense to *Hill v. Gateway 2000* rests on the normative structure the Judge envisions and wishes to impose on contractual transactions. In Section Two, I unravel this normative structure by discussing the Judge's opinion. I explain how the Judge uses the word "sense" in Section Three. In Section Four, I demonstrate how the Judge's use of the word "sense" can be understood within the language of the theory of norms, drawing on the work of Robert Ellickson. Section Five summarizes and concludes.

## II. AN UPHILL BATTLE AGAINST GATEWAY 2000: THE FACTS AND RESULT OF THE CASE

Rich and Enza Hill ordered a computer from Gateway 2000 over the phone. The computer arrived in a box which also contained an invoice with a list of terms, including warranties and a thirty-day return policy. The critical term was one requiring arbitration to settle any disputes with the vendor company. Thirty-plus days later a dispute arose, and the Hills

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<sup>8</sup> 105 F.3d 1147.

<sup>9</sup> 86 F.3d 1447 (7th Cir. 1996).

sued in federal court.<sup>10</sup> Gateway 2000 was unsuccessful in dismissing the suit by enforcing the arbitration clause because the court found that “the present record is insufficient to support a finding of a valid arbitration agreement between the parties or that the [Hills] were given adequate notice of the arbitration clause.”<sup>11</sup> The Seventh Circuit, in a unanimous opinion authored by Judge Easterbrook, ruled in favor of the company and reversed the district court.<sup>12</sup> The following language from the Judge’s opinion best expresses the spirit of the opinion: “A contract need not be read to be effective; people who accept take the risk that the unread terms may in retrospect prove unwelcome.”<sup>13</sup>

The Court of Appeals relied largely on its prior precedent established by *ProCD v. Zeidenberg*<sup>14</sup> in reaching its result. The *ProCD* case concerned the enforcement of a “shrink-wrap license,” that is, a license contained in a box of software that the consumer was aware of only after purchasing the software and opening the box.<sup>15</sup> The court in *ProCD* held that the contract was enforceable.<sup>16</sup> In describing *ProCD* as controlling authority in the Hills’ case, the court did not mention that the issue in *ProCD* was not the enforcement of an arbitration clause, but the enforcement of a term that made the information on the software proprietary to the creator of the software. This result is controversial because the information on the software was a database, a list of names and addresses, and the Supreme Court has held that such databases could not be protected under federal copyright law.<sup>17</sup> The decision in *ProCD* is important not only

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<sup>10</sup> 1996 WL 650631 (N.D. Ill. Nov. 7, 1996).

<sup>11</sup> *Id.* at 1147-48.

<sup>12</sup> *Hill v. Gateway 2000*, 105 F.3d 1147 (7th Cir. 1997).

<sup>13</sup> *Id.* at 1148.

<sup>14</sup> 86 F.3d 1447.

<sup>15</sup> *Id.* at 1449.

<sup>16</sup> *Id.*

<sup>17</sup> *Feist Publications, Inc. v. Rural Telephone Ser. Co., Inc.*, 499 U.S. 340, 360 (1991) (holding that the taking of raw data such as names, addresses, towns, and telephone numbers from a telephone book was not a violation of the Copyright Act because this data did not “owe its origin” to the telephone service company).

because of its holding that shrink-wrap licenses are enforceable, but also because of its holding that contract law is not pre-empted by copyright law and can be used to create proprietary rights over databases.<sup>18</sup> I mention these additional facts because they help explain in part why Judge Easterbrook is so insistent that *ProCD* controls.

The Hills, of course, argued otherwise, arguing that *ProCD* is distinguishable. Their first argument is that *ProCD* is a software case and therefore inapplicable to an ordinary consumer transaction over the phone.<sup>19</sup> It is this argument that the Judge dismisses as lacking sense. I will focus on this point in the next section, but it is first important to clarify the Hills' remaining three arguments.

The Hills also attempted to distinguish *ProCD* on the ground that the contract at issue was a license and hence an executory contract.<sup>20</sup> In contrast, the contract between the Hills and Gateway 2000 was fully performed when the computer was delivered to their home.<sup>21</sup> The court rejects this view, finding that the *Hill-Gateway 2000* contract also included terms which implied an ongoing performance obligation, such as the warranties, which were promises by Gateway to cure defects.<sup>22</sup> Therefore, both the *ProCD* contract and the *Hill-Gateway 2000* contract were executory and the two cases could not be distinguished on those grounds.

The court was equally skeptical of the Hills' argument based on Uniform Commercial Code Section 2-207 ("U.C.C."). According to the Hills, the phone order constituted the offer and the shipment of the goods with the new and different terms, the acceptance.<sup>23</sup> The contract was formed as soon as the goods were shipped. The new and different terms included in the box could not become part of the contract because the transaction was between a merchant (Gateway 2000) and a non-merchant (the

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<sup>18</sup> *ProCD*, 86 F.3d 1454-55.

<sup>19</sup> *Id.* at 1449.

<sup>20</sup> *Id.*

<sup>21</sup> *Id.*

<sup>22</sup> *Id.*

<sup>23</sup> *Gateway 2000*, 105 F.3d at 1149.



Hills). Under UCC § 2-207(2), the terms of the offer (here set by the Hills) govern, and the new and different terms drop out. The court held that UCC § 2-207 did not apply because there was only one form and therefore a battle of the forms problem did not exist.<sup>24</sup>

Finally, the Hills appealed to their lack of notice of the additional terms to explain the terms' unenforceability.<sup>25</sup> The court rejected this argument as well, stating that the Hills, based either on advertisements or ordinary experience with transactions, should have known that additional terms were forthcoming.<sup>26</sup> The court points to three ways in which additional terms enter into a contract: inquiry of vendor, public documents and advertisements, and notice of the terms followed by a thirty-day return policy.<sup>27</sup> The third way applied to the Hills' case. Failure to return the computer within thirty-days constituted acceptance of the additional terms.<sup>28</sup>

What is the court, or more specifically Judge Easterbrook, doing in this opinion? One thing that is clear is that he is reconstituting the manner in which the contract was formed. According to the Hills, the contract was formed as follows: the phone order was the offer, the shipment the acceptance.<sup>29</sup> According to the Judge, however, the shipment was the offer, the failure to return was the acceptance.<sup>30</sup> The offer was made on the day the computer arrived and the acceptance occurred on the thirty-first day that the Hills kept the computer.<sup>31</sup> Under U.C.C. § 2-206(1):

Unless otherwise unambiguously indicated by the language or the circumstances (a) an offer to make a contract shall be construed as inviting acceptance

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<sup>24</sup> *Id.* at 1150 (citing *ProCD* for the proposition that UCC § 2-207 does not apply "when there is only one form").

<sup>25</sup> *Id.*

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

<sup>27</sup> *Id.*

<sup>28</sup> *Id.*

<sup>29</sup> *Gateway 2000*, 105 F.3d at 1149.

<sup>30</sup> *Id.*

<sup>31</sup> *Id.* at 1150.

in any manner and by any medium reasonable in the circumstances;

(b) an order or other offer to buy goods for prompt or current shipment shall be construed as inviting acceptance either by a prompt promise to ship or by the prompt or current shipment of conforming or non-conforming goods . . . .<sup>32</sup>

The language of U.C.C. § 2-206 is in the Hills' favor, but the language is never discussed in the opinion. Furthermore, the additional terms included with the computer are subject to analysis under U.C.C. §2-207, which states, in relevant part, that

(1) A definite and seasonable expression of acceptance . . . operates as an acceptance even though it states terms additional or different from those offered or agreed upon . . . .

(2) The additional terms are to be construed as proposals for addition to the contract. Between merchants such terms become part of the contract unless . . .

(3) Conduct by both parties which recognize the existence of a contract is sufficient to establish a contract for sale although the writings of the parties do not otherwise establish a contract.<sup>33</sup>

Under sub-section one, the additional terms do not undermine the fact that shipment constituted acceptance. These additional terms, under sub-section two, are proposals for addition to the contract. If the contract were between merchants, these terms would automatically would become part of the contract unless one of the three exceptions apply. I omit the exceptions here because the Hills were not merchants. The question is what happens under U.C.C. § 2-207 to the additional terms when one of the parties is not a merchant? Under sub-section § 2-207(2), if the parties are not both merchants, then the

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<sup>32</sup> U.C.C. § 2-206 (1993).

<sup>33</sup> U.C.C. § 2-207 (1993).

additional terms drop out of the contract and do not become part of the agreement. Application of U.C.C. sections 2-206 and 2-207 would weigh in favor of the Hills' position. Even though Judge Easterbrook concludes that § 2-207 is inapplicable because the provision governs the situation when there are two opposing forms from the offeror and the offeree, not one as in the *Gateway 2000* case, this view has been expressly rejected. As the U.S. District Court for Kansas recently stated in a case involving Gateway:

[T]he Seventh Circuit concluded without support that UCC § 2-207 was irrelevant because the cases involved only one written form . . . . This conclusion is not supported by the statute . . . . Disputes under § 2-207 often arise in the context of a 'battle of forms,' but nothing in its language precludes application in a case which involves only one form.<sup>34</sup>

Where legal analysis fails to illuminate Judge Easterbrook's reasoning, economic analysis provides an answer. However, characterizing the Judge's approach either as application of a command mechanism or a property right mechanism would miss the heart of the opinion. The Judge is not commanding an outcome to be enforced by monetary or other sanctions. Nor is he creating a property right over which the parties could bargain. In affirming *ProCD*, the Judge is affirming a norm that allows the parties to create property rights through contract. Judge Easterbrook concludes that the arbitration clause is enforceable because the Hills agreed to it. In light of his insistence on relying on *ProCD* and his appeal to "sense," the Judge's approach can best be described as one of seeding norms having to do with contractual transactions, especially the norms involving the provision of information. An analysis of how Judge Easterbrook uses the word "sense" will bolster my interpretation.

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<sup>34</sup> *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1338 (D. Kan. 2000), (citations omitted) *dismissed* 2000 WL 1372886 (D. Kan. Sept. 6, 2000).

### III. HOW JUDGE EASTERBROOK USES THE WORD SENSE

What is intriguing about the opinion is Judge Easterbrook's subverting of what is natural and traditional in contract law. Rejecting traditional unilateral contract principles and U.C.C. § 2-207 analysis, the Judge is touting the novel precedent of *ProCD* as the correct way of viewing the contract between the Hills and Gateway. The Judge's use of the word "sense,"<sup>35</sup> implying common sense, is the foundation for this rhetorical move. The Hills argued that *ProCD* be limited to the treatment of software license.<sup>36</sup> The Judge rejects this argument as lacking sense:

Plaintiffs ask us to limit ProCD to software, but where's the sense in that? [1] Pro-CD is about the law of contract, not the law of software. [2] Payment preceding the revelation of full terms is common for air transportation, insurance, and many other endeavors. [3] Practical considerations support allowing vendors to enclose the full legal terms with their products. Cashiers cannot be expected to read legal documents to customers before ringing up sales. If the staff at the other end of the phone for direct-sales operations such as Gateway's had to read the four-page statement of terms before taking the buyer's credit card number, the droning voice would anesthetize rather than enlighten many potential buyers. Others would hang up in a rage over the waste of their time. And oral recitation would not avoid customers' assertions (whether true or feigned) that the clerk did not read term X to them, or that they did not remember or understand it. [4] Writing provides benefits for both sides of

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<sup>35</sup> *Gateway 2000*, 105 F.3d at 1149.

<sup>36</sup> *Id.*

commercial transactions. Customers as a group are better off when vendors skip costly and ineffectual steps such as telephonic recitation, and use instead a simple approve-or-return device. Competent adults are bound by such documents, read or unread. [5] For what little it is worth, we add that the box from Gateway was crammed with software. The computer came with an operating system, without which it was useful only as a boat anchor. Gateway also included many application programs. So the Hills' effort to limit Pro-CD to software would not avail them factually, even if it were sound legally—which it is not.<sup>37</sup>

The word sense is used in the following five ways in this paragraph:

*Sense as generalization*

The Judge states that *ProCD* is about the law of contract, not the law of software.<sup>38</sup> Contract, meaning the law governing agreements and promises, is the correct level of generalization. There are no special rules governing software licenses as distinct from other agreements. However, the Judge ignores the point that *ProCD* is as much about copyright law as it is about contract law. The central holding in *ProCD* is that copyright law does not pre-empt contract law, and therefore a creator can protect his interest in a database not protected by copyright law through the use of contract terms.<sup>39</sup> A more appropriate generalization is that *ProCD* is about the law of intellectual property and hence irrelevant to the facts of *Gateway 2000*.

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<sup>37</sup> *Id.* at 1149 (citations omitted) [numbering added].

<sup>38</sup> *Id.*

<sup>39</sup> *ProCD*, 86 F.3d at 1455.

*Sense as empirical consistency*

The Judge states that arbitration clauses, much like that at issue in *Hill v. Gateway 2000*, are common in air transportation, insurance, and “many other endeavors.”<sup>40</sup> With this argument, the Judge turns from the general to the specific. The appeal is no longer to some uniform, governing law of contract, but to specific types of contract with which the Hills presumably have experience. The Judge seems to be making the point that a general body of law is based on empirical consistency and enforceability of the term in one context would require enforceability in other contexts. However, the level of generality is not clear here. There are ways in which air transportation and insurance differ from shrink-wrap licenses for software sold over the Internet or from contracts for computers sold over the phone. If the general rule is that arbitration clauses that are discovered after payment as part of an “approve-or-return” method of acceptance are always enforceable as a matter of contract law, what is the point of referring to the many endeavors in which the clauses arises? The Judge, by providing an empirical basis for the law of contract, is grounding the legal rule of enforceability in actual practice and empirically verifiable outcomes.

*Sense as practicability*

Here, the Judge seemingly invokes the Hand formula.<sup>41</sup> The costs of disclosing all the terms over the phone outweigh any benefits, at least as the Judge measures and balances the respective costs and benefits. He ignores the costs and benefits of disclosing the arbitration clause and the “approve-or-return” policy, the offensive terms at issue in this case. The Judge sees the requirement of full disclosure as potentially shutting down the

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<sup>40</sup> *Gateway 2000*, 105 F.3d at 1149.

<sup>41</sup> *Id.* at 1149 (referring to the Hand formula in a commercial context. The Hand formula was articulated by Judge Learned Hand and is used to determine the “burden of precaution that is warranted by calculating probability of injury times gravity of harm,” *Rhode Island Hospital Trust Nat’l Bank v. Zapata Corp.*, 848 F.2d 291 (1st Cir. 1988) (quoting *United States v. Carroll Towing Co.*, 159 F.2d 169, 173 (2d Cir. 1947))).

market for phone order computers if full disclosure were strictly followed.<sup>42</sup> This argument misses several points. First, the practicability of full disclosure rests on the mechanism of contract formation. If the contract were formed upon delivery of the merchandise, the burden would shift to Gateway to disclose all terms before delivery. Since contract formation is characterized as occurring when the Hills failed to return the merchandise, there is no incentive for prior disclosure of the terms. As a practical matter, which is closer to how consumers may view a contract formation? A consumer buying what economists call an "experience good,"<sup>43</sup> would expect that the good can be easily returned upon discovery of the defect. If I discover that the milk I bought is in fact sour, then I can go back to the grocery store and complain. It would seem to defy sense if the milk manufacturer or the grocer attached a tag to the cap which said that all disputes over the quality of the milk are to be arbitrated in Geneva.

There are two practical issues that the Judge ignores. The first is the length of time that is necessary to discover whether the experience good meets the customer's expectations. A thirty-day period may not be adequate to discover all the possible defects that can afflict a computer. The second practical issue is one of remedy and redress. The combination of the arbitration clause and the approve-or-return policy creates a knife-edge situation. If the defect is discovered on the thirty-first day, the cost of redressing the defect is quite high. If the defect is discovered a day earlier, the cost of redress is shipping the product back. The effect of enforcing both the arbitration clause and the approve-or-return policy is to protect companies that sell products with latent defects which are difficult to detect. Although reputational markets and norms may counter this incentive, practical reasons

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<sup>42</sup> *Id.* at 1149.

<sup>43</sup> Experience goods are goods for which consumers can not make valuations of their characteristics and quality prior to purchase. Franklin J. Mixon, *Customer Return Policies for Experience Goods: The Impact of Product Price and Consumer Search Costs on Seller-Provided Informational Cues*, 31 APPLIED ECONOMICS at 331 (1999).

for allowing each term separately do not add up to enforcing both terms together.

*Sense as efficiency enhancing*

The Judge reasons that customers are made better off by the approve-or return policy.<sup>44</sup> There is no elaboration on how these benefits arise except in reducing the costs to the vendor or engaging in what the Judge characterizes as long and ineffective recitation of terms.<sup>45</sup> Presumably, these costs are passed on to the consumer. Furthermore, the Judge discusses how competent adults are bound by terms, whether they are read or not.<sup>46</sup> There is an analogy with market exchange that is being made in this discussion. If I pay X dollars for a product, there is a presumption that I value the product at X dollars or more. The consent principle in contract is a proxy for the efficiency of the contract. The Judge is expanding the consent principle quite a bit here and is engaging in part in *propter hoc* reasoning. His logic can be described as follows: approve-or-return benefits consumers. Therefore, consenting to approve-or-return policies would promote efficiency. Since these terms arose from an approve-or-return policy, the terms must be efficient and enforced. However, there is a presumption of consent in this reasoning. There is an even stronger assumption that since consent implies efficiency, the efficiency of terms would imply that a customer would consent to them. This last point is specious not only because of the confusion of necessary and sufficient conditions, but also because it is not clear what is the basis for determining that certain terms are efficient, other than the court's *ipse dixit*.

*Sense as precedent*

The Judge's last interpretation of sense comes full circle to the question of generalization. While the Judge begins by

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<sup>44</sup> *Gateway 2000*, 105 F.3d at 1149.

<sup>45</sup> *Id.*

<sup>46</sup> *Id.*



stating that *ProCD* is about contract, not software,<sup>47</sup> he ends by stating that even if *ProCD* were about software, the facts of the Hills' case implicate software and therefore *ProCD* should apply *a fortiori*.<sup>48</sup> Here, we witness a typical argument by precedent. The Judge is not denying that the precedent of *ProCD* applies at a high level of generality; he is stating that there is no distinction between that case and the case at hand. Of course, by concluding that the two cases are the same, the judge ignores the differences, the principal one being the difference between enforcing a shrink-wrap license and the enforcing terms that are subject to an approve-or-return policy. The question we are left with is: what is the sense in ignoring that distinction?

The Judge uses "sense" in five different ways in his opinion. The first and the fifth ways can be described as 'process based' definitions that look to case interpretation and precedent in gauging the sense of treating *ProCD* as the applicable precedent. The second way can be described as an appeal to empiricism. An act is commonsensical if it is similar to acts in other contexts. The third and fourth ways are appeals to practicality and economic efficiency. Something is commonsensical if it generates positive net benefits or efficiencies.

In characterizing the Hills' argument as non-sensical, the Judge is affirming several legal and market based norms. The first is the norm of judicial craftsmanship and common law rule making through precedent. The Judge, by appealing to precedent, is asserting its naturalness as the only way of determining a particular legal issue. Of course, the Judge also overlooks the many ways he has to sidestep precedent to reach the result. The second norm is that of practice. The best measure of the right thing to do is determining what others have done in similar situations. The norm is similar to that of judicial craftsmanship and precedent in that it aims at consistency. But while the first norm focuses squarely on judicial practice, the second focuses on practice in the marketplace and in the community. The difficult question avoided is, what is the

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<sup>47</sup> *Id.*

<sup>48</sup> *Id.*

relevant marketplace and community? The Judge refers to air transport and insurance and “other endeavors”<sup>49</sup> without a careful parsing of the differences among the various representative markets or communities. The third norm is that of wealth-maximization or utilitarianism. I use the two terms interchangeably here, even though they are very different, to reflect the Judge’s conflation of these two approaches under the general umbrella of efficiency.

Why is the Judge affirming these norms? These norms reflect a pro-Freedom of Contract position. His choice of examples and reasoning reflect his feeling that Gateway should win either way because the Judge is pro-business inherently or pro-technology. The choice of norms also illustrates an attempt to decentralize norm creation. Future rules governing these transactions will be determined by contract terms that can be dictated by Gateway or other sellers. Courts should defer to what companies define to be the practice regarding consumer transactions.

#### IV. CREATING CONTRACT NORMS AFTER *ProCD*

Professor Ellickson develops a theory of controller-selecting norms, that is, norms governing the mechanisms of social control.<sup>50</sup> He lists five possible mechanisms: the self, express contract, informal social forces, hierarchy, and the state.<sup>51</sup> Controller-selecting norms are the meta-norms that allocate the goal of social control among these five mechanisms. The *Gateway 2000* case also illustrates controller-selecting norms. The specific norm it illustrates is that of judicial decision making as the meta-norm that allocates social control among express contract, the state, and the self. All of these mechanisms of social control interact in the *Gateway 2000* case. The Judge’s opinion delegates control to the business entity in designing the terms of the contract, which must be internalized by the customer in his dealing with the business entity.

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<sup>49</sup> *Gateway 2000*, 105 F.3d at 1149.

<sup>50</sup> Ellickson, *supra* note 5, at 240-64.

<sup>51</sup> Ellickson, *supra* note 5, at 240.

My analysis of the case raises some of the issues analyzed by Robert Cooter in his theory of social obligations. Professor Cooter points out that norms are subject to lock-in and tipping effects.<sup>52</sup> His point is that there are switching costs to norms but once these are overcome, a superior norm can lead to tipping to a different norm.<sup>53</sup> The role of regulation, according to Professor Cooter, is to affect switching costs and tipping.<sup>54</sup> Judge Easterbrook's opinion raises the switching costs of norms and inhibits tipping. By adopting a pro-business stance to norm creation, Judge Easterbrook allows businesses like Gateway to dictate the terms of consumer transactions. Because of switching costs, such pro-business norms are likely to persist. By enforcing arbitration clauses such as the one at issue in the *Gateway 2000* case, Judge Easterbrook effectively raises the switching costs and makes tipping difficult, if not impossible. Since courts are the primary mechanism for tipping, requiring enforcement through arbitration makes it impossible for courts to act. The process based norm further raises the switching costs and makes tipping difficult. In light of statutory regulation of warranties and arbitration terms, another way of viewing Judge Easterbrook's opinion is as a mechanism of tipping consumer transactions from a pro-regulatory norm to one that is deregulatory and pro-business. In other words, Judge Easterbrook's opinion itself illustrates the lock-in and tipping phenomenon described by Professor Cooter.

## V. CONCLUSION

Judge Easterbrook's opinion in *Hill v. Gateway 2000*<sup>55</sup> represents a viewpoint based on Freedom of Contract. But this freedom, like most, does not spring naturally from the ground or emerge, like Athena, from the mind of Zeus (or a judicial equivalent). Freedom of Contract is a norm that is created and

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<sup>52</sup> Cooter, *supra* note 5, at 976-77.

<sup>53</sup> Cooter, *supra* note 5, at 976-77.

<sup>54</sup> Cooter, *supra* note 5, at 976-77.

<sup>55</sup> 105 F.3d 1147.

accepted and made part and parcel of how social interactions are viewed. The opinion offers a startling example of how the norm of Freedom of Contract is fashioned.

Another way to characterize the Judge's approach in the *Gateway 2000* decision is 'libertarian regulation.' Though this term is oxymoronic, it captures the fact that even libertarianism, the principle that freedom is absolute, requires regulation for it to function. And often this regulation is more than minimal. In an opinion that hales<sup>56</sup> Freedom of Contract and affirms the ascendancy of alternative dispute resolution, Judge Easterbrook has unsubtly demonstrated the centrality of the common law process in creating and establishing the norms that make free markets and Freedom of Contract possible.

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<sup>56</sup> The use of the verb "hale" is intended as a pun. The reference is to the work of Robert Hale, who was an early law and economics scholar and legal realist. His ideas on law and markets, especially those on the legal foundations of freedom of contract, are carefully laid out and analyzed in a book by Barbara Fried. *PROGRESSIVE ASSAULT ON LAISSEZ-FAIRE: ROBERT HALE AND THE FIRST LAW AND ECONOMICS MOVEMENT* (1998).

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