
VIRGINIA LAW REVIEW

VOLUME 92

JUNE 2006

NUMBER 4

ARTICLES

TAKING INFORMATION SERIOUSLY: MISREPRESENTATION AND NONDISCLOSURE IN CONTRACT LAW AND ELSEWHERE

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INTRODUCTION

PRODUCTS liability law often imposes on manufacturers a “duty to warn”;¹ and consumer protection statutes regularly prohibit misleading statements or require the disclosure of information.² As I describe below, the common law of contracts also attempts in various ways to regulate the information that parties exchange.

However, as I also describe below, contract law (and contract law scholarship) has yet to come to grips with the practical issues involved in regulating information. Moreover, by ignoring these practical issues, courts and scholars have also failed to appreciate many of the policy issues that are implicated in misrepresentation and nondisclosure cases. For instance, the disclosure of information can produce costs as well as benefits, so it is often hard to decide *which* information should be disclosed in any given case. Similar costs and benefits are often involved even in cases involving false statements (misrepresentations), where liability might seem less controversial.

Part I will describe the existing scholarship on contract law, insofar as it has considered information issues at all. Part II then will address the problem of nondisclosure: If we want contracting parties to disclose something, what precisely should they disclose and how should they disclose it? In brief, I will argue that such decisions require balancing the costs and benefits of each incremental disclosure, similar to that discussed in the scholarship on federal consumer protection law, and occasionally in products liability law. That is, additional disclosure can sometimes produce benefits; but it can also be costly by obscuring other, more important information.

¹ See, e.g., James A. Henderson, Jr. & Aaron D. Twerski, *Doctrinal Collapse in Products Liability: The Empty Shell of Failure to Warn*, 65 N.Y.U. L. Rev. 265 (1990); Howard Latin, “Good” Warnings, Bad Products, and Cognitive Limitations, 41 UCLA L. Rev. 1193 (1994); Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. Rev. 630, 693–721 (1999).

² See, e.g., Wesley A. Magat & W. Kip Viscusi, *Informational Approaches to Regulation* (1992); Howard Beales et al., *The Efficient Regulation of Consumer Information*, 24 J.L. & Econ. 491 (1981).

In deciding whether any given disclosure is desirable, both benefits and costs must be considered.

Part III will take up the problem of misrepresentation, arguing that similar cost-benefit analyses are often required even to decide when to prohibit false or misleading statements. To be sure, prohibiting misleading statements might seem less difficult or controversial if misleading statements never have any positive value. Often, though, the very statement that misleads people in some respects may convey truthful and useful information in others, in which case banning the statement will again result in costs as well as benefits. In other cases, the best response to misrepresentation is not to ban the misleading statement, but to require additional information in order to cure the misleading effect. But requiring the disclosure of additional information may impose costs of its own, just as it does in the nondisclosure cases analyzed in Part II.

Finally, Part IV briefly will discuss another possible use of doctrines such as misrepresentation and nondisclosure, which is to hold a party strictly liable for certain risks *even when there is nothing that party can or should have changed* with respect to the information she provided. In effect, this form of liability is more akin to strict liability (or enterprise liability), in which the party held responsible for certain risks will have to reflect those risks in the price she charges. In other cases, though, where the law aims to alter the *information* that contracting parties provide, Part V will suggest some practical reforms designed to help courts in that task.

I. THE EXISTING CONTRACTS SCHOLARSHIP

Many of the incentives created by contract law stem from the fact that those who breach contracts are held strictly liable for the breach itself, without regard to any information they might have communicated. However, some rules of contract law regulate the parties' *informational* behavior, by creating incentives for parties to alter the information they convey. For example, under the rule of *Hadley v. Baxendale*, damages for breach may depend on what the non-breacher told the breacher about the extent of any losses that

breach would inflict.³ More generally, the doctrines of mutual and unilateral mistake sometimes condition liability itself on the information that was (or was not) communicated prior to the contract.⁴ In a similar way, the rules of contract formation (including the doctrine of unconscionability) sometimes block the enforcement of entire terms that were not adequately communicated in advance.⁵ In addition, misrepresentation and nondisclosure can themselves be grounds for rescinding an otherwise valid contract, as well as (in some cases) the basis for damages in tort.⁶

Until recently, the scholarly literature on contract law contained little analysis of misrepresentation and nondisclosure. To be sure, an early article by Professor Anthony Kronman emphasized the possible disincentive that might be created if the law required a party to disclose information that it had collected at great cost—for example, if an oil company that hoped to purchase oil-rich lands was required to disclose to the current landowner the results of the oil company's detailed explorations and surveys.⁷ But these cases, where one side makes a costly investment to acquire information about an object's true value (and then resists disclosing that information), are relatively rare in the case law.⁸ More commonly, misrepresentation and nondisclosure are used against parties who fail

³ (1854) 156 Eng. Rep. 145, 151 (Ex.). For an economic analysis, see, for example, Lucian Ayre Bebchuk & Steven Shavell, Information and the Scope of Liability for Breach of Contract: The Rule of *Hadley v. Baxendale*, 7 J.L. Econ. & Org. 284 (1991).

⁴ For economic analyses, see, for example, Anthony T. Kronman, Mistake, Disclosure, Information, and the Law of Contracts, 7 J. Legal Stud. 1 (1978); Janet Kiholm Smith & Richard L. Smith, Contract Law, Mutual Mistake, and Incentives to Produce and Disclose Information, 19 J. Legal Stud. 467 (1990); Eric Rasmusen & Ian Ayres, Mutual and Unilateral Mistake in Contract Law, 22 J. Legal Stud. 309 (1993).

⁵ See, e.g., *Lefkowitz v. Great Minneapolis Surplus Store, Inc.*, 86 N.W.2d 689, 691–92 (Minn. 1957) (refusing to enforce a store's undisclosed policy of offering its sale price only to women). On the informational aspects of the unconscionability doctrine—including the issue of what should count as “adequately communicated”—see, for example, Richard Craswell, Property Rules and Liability Rules in Unconscionability and Related Doctrines, 60 U. Chi. L. Rev. 1, 47–60 (1993).

⁶ See generally Restatement (Second) of Contracts §§ 159–64 (1981); Restatement (Second) of Torts § 551 (1977).

⁷ Kronman, *supra* note 4, at 13–18, 21. For a subsequent, more formal economic analysis of this and related issues, see Steven Shavell, Acquisition and Disclosure of Information Prior to Sale, 25 RAND J. Econ. 20 (1994). Other articles will be cited below as they become relevant.

⁸ Rare, but not unheard of. See, e.g., *Mallon Oil Co. v. Bowen/Edwards Assocs.*, 965 P.2d 105, 107–08 (Colo. 1998) (en banc).

to disclose inconveniently unfavorable information they acquired in the ordinary course of business, or who misrepresent matters in an attempt to cover up some unfavorable fact.

More important, virtually all of the contract law literature on misrepresentation and nondisclosure adopts what I shall refer to as a “quantized” or “particle-based” view of information. On this view, all information can be decomposed into its smallest particles or bits; and each bit will consist of only a single assertion, so each bit must therefore either be true (accurate) or false (inaccurate). In addition, the quantized view also assumes that disclosure is a binary or an all-or-nothing trait (when applied to these smallest possible bits of information). Under the quantized view, therefore, there can be no such thing as greater or lesser *degrees* of disclosure of any single bit.

Once these assumptions are accepted, a quantized view can restrict its attention to just three possible states. If, for example, the probability of some product defect is taken to be a single bit of information, the quantized view holds that this probability must either have been (1) disclosed accurately (full disclosure), (2) not disclosed at all (nondisclosure), or (3) disclosed inaccurately (misrepresentation). On this view, it seems perfectly natural to regard disclosure rules as requiring parties to choose (1) rather than (2), with the desirability of that choice turning on the costs and benefits of full disclosure. Similarly, it also seems natural to treat the prohibition of misrepresentations as requiring parties to choose (2) rather than (3), and this choice should be uncontroversial if false bits of information have no value at all.⁹

For many purposes, of course, these assumptions about discrete bits of information can be useful ways of abstracting from the details of any given disclosure or representation.¹⁰ However, these assumptions are problematic when analyzing legal rules that directly regulate information, for information in the real world is more

⁹ See, e.g., Richard A. Posner, *Economic Analysis of Law* 111 (6th ed. 2003) (“The liar makes a positive investment in manufacturing and disseminating misinformation. This investment is completely wasted from a social standpoint, so naturally we do not reward him for his lie.”).

¹⁰ Indeed, I have used similar simplifying assumptions myself. Richard Craswell, *Performance, Reliance, and One-Sided Information*, 18 *J. Legal Stud.* 365 (1989) (combining all information into a single parameter representing the probability of the seller’s performance). But see *id.* at 396–97 (noting the artificiality of this simplification).

complex than the quantized view suggests. As I discuss below, any single bit of information can usually be disclosed with greater or lesser effectiveness (depending, for example, on how much prominence the information is given), so the nondisclosure issue often turns on questions about *how much* disclosure is adequate, rather than on a binary choice between full disclosure and nondisclosure. In addition, some particles of information may convey more than a single proposition, and thus can be both true *and* false, in the sense of conveying accurate information about some matters while conveying inaccurate inferences about others.¹¹ The quantized view of information assumes that it should always be possible to break such particles down into still smaller particles, in order to eliminate the particle containing the false information while leaving the truthful information untouched. In practice, though, it is not always possible to separate the true from the false, so even preventing misrepresentation often requires decisions about what bits of accurate information are worth giving up in order to get rid of the inaccurate bits.

Each of these points will be discussed at greater length in Parts II and III. In this Part, my only aim is to show how the existing literature on contract law has yet to address any of these complexities. For example, the Kronman article referred to earlier followed the quantized view in focusing on what he took to be single bits of information—say, the probability that there is oil under some land—which he then assumed would either be fully disclosed or not disclosed at all.¹² Of course, Kronman made a valuable contribution in analyzing one cost of required disclosures, pointing out that such requirements might reduce a company's incentive to gather that information in the first place. But in cases where that cost was not dispositive, and where disclosure might therefore be justified, Kronman had nothing to say about any other costs that might be entailed by, for instance, increasing the specificity of the information disclosed, or by giving greater prominence to any given disclosure. In short, Kronman was concerned with disclosure at a very abstract level—should we disclose or not?—and did not

¹¹ The metaphor of information as a wave, rather than a particle, is probably not very useful here—but I mention it anyway, just in case.

¹² Kronman, *supra* note 4. A similar assumption is made by Smith & Smith, *supra* note 4, and Rasmusen & Ayres, *supra* note 4.

address micro-level questions about the exact content and format of any disclosure.

Perhaps as a result, most subsequent analyses of information in contract law have operated at a similar level of abstraction. For example, Professor Kim Scheppele has opposed Kronman's conclusions with a contractarian analysis, arguing that contracting parties should not be allowed to keep silent if they possess information about risks that the other party has no reason to be thinking of ("deep secrets," in Scheppele's terms).¹³ She also argues that parties should disclose information concerning risks that the other party is already thinking about ("shallow secrets") in cases where the party who has the information got it because of some special advantage or unequal access. Thus, if *A* knows that her land is about to fall under a completely unprecedented zoning restriction (a "deep secret"), Scheppele would require her to disclose that fact prior to selling her land to *B*. If the zoning restriction is not completely unprecedented, so that *B* should have known enough to realize that there was a risk (a "shallow secret"), *A* would not have to disclose any information that *B* could have acquired with equal ease; but she would have to disclose information that *A* acquired because of, say, a special relationship with the head of the zoning board.¹⁴

While much could be said concerning the merits of Scheppele's arguments, my only point here concerns the issues she did not even attempt to address. In effect, Scheppele assumed that there was a single bit of information (the probability of a zoning restriction);

¹³ Kim Lane Scheppele, *Legal Secrets: Equality and Efficiency in the Common Law* 119 (1988).

Other recent discussions of contract law's nondisclosure rules—all couched at a similarly abstract level of analysis—include Christopher T. Wonnell, *The Structure of a General Theory of Nondisclosure*, 41 *Case W. Res. L. Rev.* 329 (1991); Randy E. Barnett, *Rational Bargaining Theory and Contract: Default Rules, Hypothetical Consent, the Duty to Disclose, and Fraud*, 15 *Harv. J.L. & Pub. Pol'y* 783 (1992); Andrew Kull, *Unilateral Mistake: The Baseball Card Case*, 70 *Wash. U. L.Q.* 57 (1992); Alan Strudler, *Moral Complexity in the Law of Nondisclosure*, 45 *UCLA L. Rev.* 337 (1997); and Melvin A. Eisenberg, *Disclosure in Contract Law*, 91 *Cal. L. Rev.* 1645 (2003).

For a notable exception to this generalization, showing a much greater sensitivity to the costs and benefits of very specific disclosures, see Lauren E. Willis, *Decisionmaking & the Limits of Disclosure: The Problem of Predatory Lending* (Working Paper, June 2005) (unpublished manuscript, on file with the Virginia Law Review Association).

¹⁴ Scheppele, *supra* note 13, at 119–24 (discussing *Dyke v. Zaiser*, 182 P.2d 344 (Cal. Ct. App. 1947), and *Jappe v. Mandt*, 278 P.2d 940 (Cal. Ct. App. 1955)).

and she also assumed that that bit of information either would be disclosed in its entirety, or not disclosed at all. Scheppele did not, however, consider such issues as the exact content of any required disclosure, or the format in which such a disclosure ought to be made. (For example, should *A* disclose a verbatim transcript of her conversation with the head of the zoning board? Or should she instead have to disclose the numerical probability of a zoning change—and, if so, how should that probability be determined?) Nor did Scheppele consider how smaller units of analysis might affect the initial determination as to whether the secret in question was “deep” or “shallow.” (Is it a shallow secret if *B* knew that there was a risk of some kind of change in the zoning laws, but had no idea that *particular* change was in the cards? What if he had no idea that the zoning laws were likely to change, but he did know there was always a risk of *some* change in the legal environment?)

A somewhat more concrete approach can be found in a recent book by Professors Ian Ayres and Gregory Klass.¹⁵ Ayres and Klass are concerned with misrepresentations and nondisclosure involving one particular subset of information: information about the probability that a given contract will be performed. Ayres and Klass note that the law often treats a promise as implicitly asserting that the promisor intends to perform the promise,¹⁶ so that someone who says, “I promise to deliver my car for \$5000” has misrepresented her intentions if that person intends all along not to deliver the car. Such a promise, Ayres and Klass conclude, is both a “performative” speech act (one that creates a legally enforceable contract) and a “constative” speech act (one that makes a descriptive assertion about the state of the world). The performative act is what gives rise to ordinary liability for breach of contract, but the false descriptive assertion is what could give rise to liability for misrepresentation.¹⁷

Significantly, then, Ayres and Klass implicitly reject what I am calling the “quantized” view of information by recognizing that any

¹⁵ Ian Ayres & Gregory Klass, *Insincere Promises: The Law of Misrepresented Intent* (2005) [hereinafter Ayres & Klass, *Insincere Promises*]. Parts of Ayres and Klass’s analysis can also be found in Ian Ayres & Gregory Klass, *Promissory Fraud Without Breach*, 2004 *Wis. L. Rev.* 507.

¹⁶ Ayres & Klass, *Insincere Promises*, supra note 15, at 21–22.

¹⁷ *Id.*

single bit or speech act (in this case, the promise) can do more than one thing. As a consequence, they also recognize that it may not be possible to get rid of some misrepresentations without getting rid of some useful speech as well. That is, if a promise *by itself* conveys a false impression, then eliminating the false impression might require eliminating the promise itself. To be sure, in cases where the promisor has absolutely no intention of performing the promise, getting rid of an insincere promise may be no great loss. In other cases, however, discouraging promises could have costs as well as benefits, and Ayres and Klass are properly sensitive to those costs.¹⁸

Nevertheless, even Ayres and Klass abstract from most of the practical details of any disclosure regime, and thus do not address the issues with which I am concerned here. For instance, they do point out that some false impressions might be eliminated without eliminating the promise itself, if the promisor were to disclose additional information¹⁹—for example, “I promise to sell my car for \$5000, *but you should know that there is a 15% chance that I might not be able to deliver it.*” However, Ayres and Klass do not address such questions as what, precisely, ought to be disclosed by such a promisor, or how much prominence those disclosures ought to be given, or when such disclosures would be cost-effective. As a result, even Ayres and Klass do not fully come to grips with all of the costs and benefits involved in preventing misrepresentation.

Of course, scholars like Kronman, Scheppele, or Ayres and Klass were not intending to speak to the most practical details of any disclosure requirement, so the preceding paragraphs should not be read as a criticism. If, however, a regulatory agency were to mandate disclosures, all of these practical issues would have to be resolved as the details of the regulation were hammered out. And it is precisely at this point—when the details of legal rules are being worked out—that the quantized view of information ceases to be useful. When one is trying to decide precisely what ought to be disclosed and how, it is no longer helpful to speak of an abstract particle of information such as “the probability of performance.” At that point, we need a more finely grained analysis of the material to be

¹⁸ See *id.* at 88. These costs also have been emphasized by Kevin E. Davis, *Promissory Fraud: A Cost-Benefit Analysis*, 2004 *Wis. L. Rev.* 535, 541–44.

¹⁹ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 106, 163.

disclosed, including the precise form in which a disclosure might be made. Only by understanding these applied or practical issues can we fully understand when liability for misrepresentation or nondisclosure might be justified.

Accordingly, Part II of this Article recasts the issue in the way that a regulatory agency might approach it, as a problem in designing an optimal disclosure rule. Part III will consider the same problem through the lens of misrepresentation, analyzing it as a regulatory agency might approach the task of optimally prohibiting misleading statements. But because nondisclosure and misrepresentation are so closely linked (as I hope to demonstrate in Part III), it will be easier to begin with nondisclosure.

II. LIABILITY FOR NONDISCLOSURE

Current contract law has difficulty defining the exact circumstances under which one party may void a contract on the grounds that the other party failed to disclose important information. For example, the Second Restatement of Contracts suggests that nondisclosure can be equivalent to a misrepresentation—thereby potentially giving grounds for rescission—under a variety of circumstances, most generally those where the fact that was not disclosed would have corrected a mistake “as to a *basic* assumption on which that [other] party is making the contract.”²⁰ However, the Restatement pointedly refuses to give any general criteria for distinguishing “basic” assumptions from other, less basic ones.²¹ “Basic” seems to mean something more than “material,” for even when the nondisclosure does go to a “basic” assumption, it must also be shown

²⁰ Restatement (Second) of Contracts § 161(b) (1981) (emphasis added). Nondisclosure may also be grounds for rescission in other, more specialized circumstances—for example, when it is necessary to correct a previous misrepresentation, or when a fiduciary relationship exists. *Id.* § 161(a), (d). For an empirical survey of the case law, see Kimberly D. Krawiec & Kathryn Zeiler, Common-Law Disclosure Duties and the Sin of Omission: Testing the Meta-Theories, 91 Va. L. Rev. 1795 (2005). For more conventional doctrinal surveys, see Nicola W. Palmieri, Good Faith Disclosures Required During Precontractual Negotiations, 24 Seton Hall L. Rev. 70 (1993), as well as the articles cited *supra* in note 13.

²¹ Restatement (Second) of Contracts § 161(b) cmt. d (1981); see also *id.* § 152(1) cmt. b (using a similar “basic assumption” test for release from a contract on grounds of mistake); *id.* § 266(2) (using a similar test for release on grounds of impracticability or frustration).

that the nondisclosed fact would have been or was intended to be “material.”²² And even if the fact in question is both “basic” and “material,” nondisclosure still is not grounds for rescission unless it also amounts to a failure to act “in good faith and in accordance with reasonable standards of fair dealing.”²³

Rather than trying to further parse these vague criteria, I propose here to approach this issue on a clean slate, as if we were trying to decide what any party *ought* to disclose about the deal she is offering. The point initially raised by Kronman is still relevant: If requiring disclosure of certain information would deter a firm from gathering that information in the first place, a disclosure requirement would be counterproductive.²⁴ But even if that is not the case—that is, even if the information would have been gathered anyway—an effective disclosure regime must still consider such issues as which attributes of the deal are most important, which information about those attributes is likely to be most useful, and in what format that information could best be disclosed. As I demonstrate below, each of these issues requires close attention to a number of costs and benefits.

A. Which Attributes Are Most Important?

It is sometimes said—though rarely seriously believed—that the law should require “full” disclosure.²⁵ The reason such statements cannot be taken literally is that truly full disclosure will usually be impossible. Even for the simplest contracts, there is generally far more information that *might* be disclosed than it would ever be possible to communicate.

²² Id. § 162.

²³ Id. § 161(b). The authors of the Restatement did not explain what distinguishes “reasonable” standards of fair dealing from other standards of fair dealing.

²⁴ See *supra* note 7 and accompanying text. Obviously, this concern arises only with disclosure rules that condition liability on the defendant’s actual knowledge of the information to disclose, thereby allowing firms to avoid liability by remaining ignorant. If, instead, the disclosure rule also requires firms to gather that information (as in various mandatory testing programs), Kronman’s concern is no longer an issue.

²⁵ Compare the position described (though not endorsed) by Henderson and Twerski as follows: “[U]sers and consumers have a right to know *the complete truth* about the risks to which they are being exposed by defendants’ products, however remote those risks may be. Nothing less than their personal integrity as human beings is at stake.” Henderson & Twerski, *supra* note 1, at 295 (emphasis added).

Consider, for instance, Ayres and Klass's concern with the probability of nonperformance. In most contracts there are any number of ways in which a party might fail to perform, each of which will be associated with a different probability. For example, a seller might fail by not delivering her goods on time, but she also might fail (with a different probability) by delivering goods of an inadequate quality. And since there are usually many different ways in which goods might be of inadequate quality, even "the risk of inadequate quality" is a composite of dozens or even hundreds of separate risks.

Moreover, most contracting parties will be interested in other issues in addition to the probability of the other party's performance. For example, if the seller has not warranted the quality of her goods, the delivery of low-quality goods would not count as a "failure to perform," but many buyers might still benefit from information about this probability. Buyers might also benefit from information about other matters beyond the scope of what was actually promised—for example, information about how much value the seller's product would give them in any particular use, or information about any drawbacks or side-effects associated with the product's use.

More generally, other pieces of potentially valuable information have even less connection to any actual "failure to perform" the contract. For instance, contracts transfer an entire set of legal rights and remedies, many of which are defined by terms hidden in the fine print of a contract: a "contract" that some buyers may not even see until after the product has arrived.²⁶ Buyers might well benefit from a more explicit disclosure of information about the existence of some or all of those terms—as, indeed, courts have often ruled when refusing to enforce such terms, either under the unconscionability doctrine or under the related doctrine of "reasonable expect-

²⁶ See, e.g., *Klocek v. Gateway, Inc.*, 104 F. Supp. 2d 1332, 1340–42 (D. Kan. 2000) (refusing to enforce an arbitration clause in a standard-form contract contained inside the box of a computer ordered from a mail-order firm). For discussions of this issue see, for example, Batya Goodman, *Honey, I Shrink-Wrapped The Consumer: The Shrink-Wrap Agreement as an Adhesion Contract*, 21 *Cardozo L. Rev.* 319 (1999); Margaret Jane Radin, *Humans, Computers, and Binding Commitment*, 75 *Ind. L.J.* 1125 (2000); Mark E. Budnitz, *Consumers Surfing for Sales in Cyberspace: What Constitutes Acceptance and What Legal Terms and Conditions Bind the Consumer?* 16 *Ga. St. U. L. Rev.* 741 (2000).

tations.”²⁷ Buyers might also benefit from information relating to the seller’s actual practice under these terms. For example, does a seller *always* insist that her only obligation with respect to defective products is to offer a replacement, if that is the only remedy promised in her standard form? Or does she sometimes offer buyers a full refund anyway, even if she is not legally obliged to do so? And if she only *sometimes* offers a more generous remedy, how often (or with what probability) does she do that?

In short, there is a lot of information about every contract that might conceivably be disclosed. As a practical matter, though, disclosing all of this information is impossible. As a result, any disclosure rule will have to prioritize: It will have to distinguish those attributes of the contract that are worth disclosing from those that are not.

Of course, legislatures and regulatory agencies routinely have to prioritize in this way. Given the costs of a statute or an agency rulemaking, no legislature or agency would attempt to pass disclosure rules on every conceivable topic. Moreover, even when a statute or regulation does require disclosure, it does not require that every possible fact be disclosed. For example, when Congress passed the Nutritional Labeling and Education Act of 1990, it directed that food labels list information concerning nine of the most important nutrients, even though dozens of other nutrients might be relevant to consumers.²⁸ Similarly, the Federal Trade Commission (“FTC”) chose to require disclosure of the insulating power (or “R-value”) of each brand of home insulation, but not to require disclosure of each brand’s average life expectancy or its cost per square foot.²⁹ While it might of course be debated whether these bodies made the correct choice about which information to disclose, it is clear that some sort of prioritizing took place.

Similar concerns have begun to inform the debate in products liability law about firms’ duty to warn their customers about the

²⁷ On this use of the unconscionability doctrine, see Craswell, *supra* note 5, at 51–60, and the other articles cited there. On the reasonable expectations doctrine see, for example, Kenneth S. Abraham, *Judge-Made Law and Judge-Made Insurance: Honoring the Reasonable Expectations of the Insured*, 67 *Va. L. Rev.* 1151, 1162–68 (1981).

²⁸ See 21 U.S.C. § 343(q)(1)(D) (2000). This Act also changed the Food and Drug Administration’s (“FDA”) authority to regulate potentially misleading nutrition claims: I discuss that aspect of the Act *infra* in Part III.

²⁹ Labeling and Advertising of Home Insulation, 16 C.F.R. § 460 (2005).

risks of injury posed by various products. Many products pose some risk of injury, and some products pose the risk of many different injuries, but if all of these had to be disclosed, consumers might be inundated with warnings, and many individual warnings could lose their impact. As a result, the true cost of any given warning may include not just the physical cost of printing extra words on the product's label, but also the potentially more serious cost of diluting the effectiveness of other warnings and disclosures. In other words, if each fact that might be disclosed is seen as a separate bit or particle of information (as the quantized view would have it), the problem here is that these particles very often interact.

Indeed, some commentators argue that courts have gone too far in this regard, perhaps because each individual judge often sees only a single case involving a single risk; or perhaps because judges see cases with the benefit of hindsight, when the risk that actually materialized naturally seems the most important.³⁰ Some commentators have therefore suggested that safety warnings might be better designed by regulatory agencies than by common-law courts.³¹ Others have questioned whether warnings that are limited in this way will give purchasers enough information to make the market work, and have therefore suggested that manufacturers might instead be held liable without regard to the adequacy of their warnings, thus replacing an information-based regime with one based on enterprise liability.³² But while commentators thus differ in their recommended solutions to this problem, my point is that there is now widespread recognition—in the scholarly literature, if not always in judicial opinions—that any effective warning or disclosure regime will have to prioritize in deciding what to disclose.

What is striking, therefore, is that no similar recognition has informed the scholarly analysis of the nondisclosure doctrine in contract law. Kim Scheppele, for example, notes briefly that the law

³⁰ See, e.g., Henderson & Twerski, *supra* note 1, at 301–03; Victor E. Schwartz & Russell W. Driver, *Warnings in the Workplace: The Need for a Synthesis of Law and Communication Theory*, 52 U. Cin. L. Rev. 38, 40–45 (1983).

³¹ See, e.g., W. Kip Viscusi, *Reforming Products Liability* 155–56 (1991); Richard Epstein, *Modern Products Liability Law* 110–12 (1980); Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 Yale L.J. 353, 398 n.90 (1988).

³² See, e.g., Steven P. Croley & Jon D. Hanson, *Rescuing the Revolution: The Revised Case for Enterprise Liability*, 91 Mich. L. Rev. 683, 786–92 (1993); Latin, *supra* note 1, at 1292–94. I will return to this issue in Part IV.

could not possibly require disclosure of every bit of information (even those to which the parties have unequal access), but she devotes to this issue only four pages in an entire book.³³ Professor Melvin Eisenberg, as well, briefly notes the materiality requirement, but does not consider it worth elaborating.³⁴ And Ayres and Klass, in their more recent book, barely even mention the issue.³⁵

To be sure, standard doctrine limits rescission to cases where the information withheld was *material*—and, according to the Second Restatement, only when the information involves a basic assumption³⁶—and both of these concepts are sufficiently flexible to permit courts (if they are so inclined) to decide which pieces of information were truly worth disclosing.³⁷ In one case, for example, the court had to decide whether the seller of a home should have disclosed that a multiple murder had taken place in the house some years before the sale, when the buyers (after learning of the murder) sought to rescind their purchase.³⁸ In a thoughtful opinion, the court noted that “material” was difficult to define, and that the term was “essentially a label affixed to a normative conclusion.”³⁹ However, the court recognized that the principal normative concern was one of potentially excessive disclosures—that is, the fear that “[a]ny fact that might disquiet the enjoyment of some segment of the buying public” might have to be disclosed in order to avoid

³³ Scheppele, *supra* note 13, at 127 (“Not every secret can be the subject of a lawsuit. Inequalities in access to information are everywhere, and courts would encounter a sort of legal gridlock if all unequal information could be the subject of litigation.”). Notice, too, that Scheppele’s concern is more with excessive litigation costs, or gridlock in the courts; rather than with the effect of excessive disclosures on consumer comprehension, or gridlock on product labels.

³⁴ Eisenberg, *supra* note 13, at 1679–80.

³⁵ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 102.

³⁶ See *supra* note 22 and accompanying text.

³⁷ The concept of “materiality” can also play this role in the disclosures that are required under federal securities law, where similar concerns about excessive disclosure have been much debated. See, e.g., Donald C. Langevoort, *Toward More Effective Risk Disclosure for Technology-Enhanced Investing*, 75 *Wash. U. L.Q.* 753, 774–75 (1997); Troy A. Paredes, *Blinded by the Light: Information Overload and Its Consequences for Securities Regulation*, 81 *Wash. U. L.Q.* 417 (2003); Joan MacLeod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 *Am. U. L. Rev.* 1131 (2003).

³⁸ *Reed v. King*, 193 Cal. Rptr. 130 (Ct. App. 1983).

³⁹ *Id.* at 132.

rescission.⁴⁰ In the end, the court ruled that the murder information had to be disclosed if the buyer could prove at trial that the murders significantly reduced the home's market value (thus establishing that the issue was not of concern merely to a single, overly squeamish buyer).⁴¹

Such explicit discussions are rare, though, so courts applying the nondisclosure doctrine have not often had to consider how to use the materiality doctrine to make priority decisions about precisely which attributes ought to be disclosed. Indeed, the relative rarity of such cases may explain why the courts and commentators have yet to focus on the potential cost of excessive disclosure in contract cases, as they have in products liability cases.

The nondisclosure doctrine is a recent development in contract law: Until the middle of the twentieth century, it was often said that parties to a contract had no duty at all to disclose information to each other, as long as they did not affirmatively misrepresent anything.⁴² Moreover, a successful claim of nondisclosure usually leads only to rescission of the contract, rather than to an affirmative claim for tort damages. And while rescission may be a welcome enough remedy to the buyer who discovers, for example, that his new house is riddled with termites, rescission does not generate the huge damage awards that might make these cases attractive to plaintiffs' attorneys.

Still, if courts have not yet reached the point at which overdisclosure and prioritizing become significant, this may indicate that courts are not requiring *enough* disclosures, and that they ought to be more aggressive in this regard (as Ayres and Klass suggest).⁴³ If that happens, courts will then have to face the priority question, just as they have begun to do in products liability cases.

⁴⁰ *Id.*

⁴¹ *Id.* at 133–34. Just three years later, the California legislature passed a statute providing that any failure to disclose a death in a house due to AIDS would *not* be grounds for rescission. Cal. Civ. Code § 1710.2 (West 1998).

⁴² See, e.g., *Swinton v. Whitinsville Sav. Bank*, 42 N.E.2d 808, 808–09 (Mass. 1942) (finding the seller of a home not liable for failing to disclose a termite infestation).

⁴³ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 59–60.

B. How Should the Information Be Presented?

Even after deciding which attributes should be the subject of disclosure, many other decisions must be made concerning the exact form in which that information is presented. For example, suppose that Congress decides to require sellers of food to disclose the amounts of various nutrients in each product. Someone must still decide precisely *what* must be disclosed about each nutrient, for the amount of a nutrient can be measured or described in various ways. The amount of each nutrient could be measured absolutely, in grams; but it could also be measured in relative terms, as a percentage of the minimum daily recommended allowance of that particular nutrient, or as a percentage of the total mass of each product. To be sure, this last percentage might be less useful for users who were trying to plan their entire daily diet—but it might be *more* useful for users who wanted to shun foods that were high or low in particular nutrients. As this example illustrates, the value of different ways of presenting information will usually depend on the uses to which that information will be put.

In some cases, regulatory agencies have found it useful to construct their own index or summary statistic, as a way of condensing multiple factors into a one-dimensional variable that is easier to communicate.⁴⁴ For example, the energy used by a home appliance will vary depending on consumers' usage patterns, and the actual cost of that energy will also vary depending on local electricity rates. It might have been possible to present this data in a complicated table, so that consumers could use their own electric bills (and their knowledge of their own usage patterns) to estimate their energy costs with some precision. However, the FTC believed that few consumers had the time or the patience to calculate their actual costs in this way, so it constructed its own index of likely energy costs which allowed the costs of different appliances (relative to other appliances of the same type) to be disclosed in the form of a single "Energy Efficiency Rating."⁴⁵ In a similar way, the Environmental Protection Agency ("EPA") publishes only two indices

⁴⁴ For a general discussion of this approach, see Beales et al., *supra* note 2, at 523–27. One particular advantage of this approach—that it gives sellers an incentive to compete to improve their score on the index—will be discussed *infra* in Section II.C.

⁴⁵ Appliance Labeling Rule, 16 C.F.R. § 305 (2005).

of automobile gasoline consumption—“city” and “highway” miles-per-gallon (“MPG”) ratings—each of which is a rough attempt to reflect the driving habits of millions of different drivers.⁴⁶

In addition to deciding on the exact measures or indices to disclose, a disclosure regime may also have to regulate the exact form in which to present that information. Many of these formatting issues concern the prominence of the information—for instance, disclosures that appear in print may have to appear in sufficiently large type, and in a sufficiently prominent location. In most cases, though, effectiveness is not a function of type size alone, for the impact of any given disclosure can also be affected by whatever else is said, and whatever pictures are used, in the rest of the advertisement. The recent literature on behavioral law and economics emphasizes several of these formatting issues, ranging from the vividness of the imagery with which the information is presented to whether it is presented in terms that are positive (information about a possible benefit) or negative (information about a possible loss).⁴⁷

As a result, most regulations do not merely specify the information that must be disclosed. Instead, they also specify something about the format of the disclosure, even if it is only to mandate a particular size of type or the physical dimensions of the label.⁴⁸ Not surprisingly, then, the format of any required disclosure is often closely contested in regulatory proceedings, and the effects of different formats have frequently been studied in the product marketing literature.⁴⁹ To be sure, selecting the best format can sometimes

⁴⁶ Fuel Economy of Motor Vehicles, 40 C.F.R. § 600 (2005). I discuss some possible inaccuracies in these measures *infra* at the text accompanying note 66.

⁴⁷ See, e.g., Christine Jolls & Cass R. Sunstein, *Debiasing Through Law*, U. Chi. John M. Olin L. & Econ. (2d series) (Working Paper No. 225, Feb. 20, 2005), at <http://www.law.uchicago.edu/Lawecon/wp201-250.html>.

⁴⁸ See, e.g., 16 C.F.R. § 305.11 (2005) (specifying the size, typeface, margins, colors and paper stock for appliance energy efficiency labels). In the following section, I consider the special case where competitive forces provide sellers with their own motives for disclosing information prominently, thus reducing the need for a mandatory format.

⁴⁹ See, e.g., Magat & Viscusi, *supra* note 2, at 107–18. For studies of various aspects of nutritional labeling formats (to cite just one example), see Alan S. Levy et al., *Performance Characteristics of Seven Nutrition Label Formats*, 15 *J. Pub. Pol’y & Marketing* 1 (1996); Michael J. Barone et al., *Another Look at the Impact of Reference Information on Consumer Impressions of Nutrition Information*, 15 *J. Pub. Pol’y &*

be difficult, especially for government agencies that lack the expertise of professional marketers or advertising copywriters. At one point, the FTC considered setting its formatting requirements in terms of results, rather than in terms of specific type sizes or colors—for example, by requiring that the content of the disclosure be recalled by a minimum percentage of a sample of consumers who were exposed to it.⁵⁰

Another closely related issue concerns the potential for disclosures to interfere with the communication of other useful information. In advertising, especially, a number of studies have found that increasing the prominence of some required disclosure might (a) increase buyers' understanding or recall of the information being disclosed, while simultaneously (b) reducing their understanding or recall of other truthful information contained in the advertisement.⁵¹

Marketing 55 (1996); Sandra J. Burke et al., Displaying Common but Previously Neglected Health Claims on Product Labels: Understanding Competitive Advantages, Deception, and Education, 16 *J. Pub. Pol'y & Marketing* 242 (1997); Judith A. Garretson & Scot Burton, Effects of Nutrition Facts Panel Values, Nutrition Claims, and Health Claims on Consumer Attitudes, Perceptions of Disease-Related Risks, and Trust, 19 *J. Pub. Pol'y & Marketing* 213 (2000).

⁵⁰ See, e.g., *In re RJR Foods, Inc.*, 83 F.T.C. 7, 16 (1973) (consent order requiring beverage manufacturer to make affirmative disclosures about fruit juice content until meeting target results in consumer surveys). For analyses of this approach to information regulation, see William L. Wilkie & David M. Gardner, *The Role of Marketing Research in Public Policy Decision Making*, *J. Marketing*, Jan. 1974, at 38, 41; Beales et al., *supra* note 2, at 529–30.

⁵¹ See, e.g., Tom Meyvis & Chris Janiszewski, Consumers' Beliefs About Product Benefits: The Effect of Obviously Irrelevant Product Information, 28 *J. Consumer Res.* 618 (2002); Brian Roe et al., The Impact of Health Claims on Consumer Search and Product Evaluation Outcomes: Results from FDA Experimental Data, 18 *J. Pub. Pol'y & Marketing* 89 (1999); J. Craig Andrews et al., Consumer Generalization of Nutrient Content Claims in Advertising, *J. Marketing*, Oct. 1998, at 62; Cornelia Pechmann, Do Consumers Overgeneralize One-Sided Comparative Claims, and Are More Stringent Regulations Needed?, 33 *J. Marketing Res.* 150 (1996); David W. Stewart & Ingrid M. Martin, Intended and Unintended Consequences of Warning Messages: A Review and Synthesis of Empirical Research, 13 *J. Pub. Pol'y & Marketing* 1 (1994); Louis A. Morris et al., Risk Disclosures in Televised Prescription Drug Advertising to Consumers, 8 *J. Pub. Pol'y & Marketing* 64 (1989); Richard L. Oliver et al., A Study of Physicians' Perception of Advertising Judged Deceptive by the FDA, 11 *Advances in Consumer Res.* 224 (1984). I discuss these studies at more length in Richard Craswell, *Interpreting Deceptive Advertising*, 65 *B.U. L. Rev.* 657, 689–91 (1985) [hereinafter Craswell, *Interpreting*]; and Richard Craswell, *Regulating Deceptive Advertising: The Role of Cost-Benefit Analysis*, 64 *S. Cal. L. Rev.* 549, 567 (1991) [hereinafter Craswell, *Regulating*].

Increasing the prominence of a required disclosure may also reduce the attention consumers pay to other information, conceivably leading to worse decisions rather than better ones. For example, a recent FTC study found that a proposed disclosure of brokerage fees paid to mortgage brokers caused many consumers to overestimate the total cost of loans obtained through mortgage brokers, as compared to the cost of “traditional” mortgages obtained from direct lenders.⁵² As a consequence, the Department of Housing and Urban Development (which had originally proposed the disclosure of brokerage fees), withdrew its proposal for further consideration.⁵³

Neither of these effects is inevitable, of course: Sometimes information can be communicated with no interference at all with other materials.⁵⁴ Typically, though, the disclosures that produce the least amount of interference are those that are the least prominent, and therefore the least effective in communicating the disclosed information. Conversely, more prominent disclosures are more likely to be more effective at conveying their own information, but these are also the ones most likely to interfere with something else. Of course, which outcome is preferable overall depends on the importance of the information being disclosed, the importance of the information that is interfered with, and the actual extent of that interference. In this respect, too, designing a disclosure format requires close attention to the relevant costs and benefits.

These formatting issues are occasionally discussed in the products liability literature, at least to the extent of recognizing that an otherwise adequate warning might be rendered ineffective by in-

⁵² See, e.g., James M. Lacko & Janis K. Pappalardo, *The Effect of Mortgage Broker Compensation Disclosures on Consumers and Competition: A Controlled Experiment 1* (Fed. Trade Comm’n, Bureau of Econ. Staff Report, Feb. 2004), available at <http://www.ftc.gov/os/2004/01/030123mortgagefullrpt.pdf>.

⁵³ The history of this proposed regulation, as seen from the FTC’s perspective, is described in Luke Froeb et al., *Economics Research at the FTC: Information, Retrospectives, and Retailing*, 25 *Rev. Indus. Org.* 353, 360–61 (2004).

⁵⁴ Studies finding no such effect (in connection with particular disclosures) include J. Edward Russo et al., *Identifying Misleading Advertising*, 8 *J. Consumer Res.* 119, 124–25 (1981); Ivan L. Preston & Jef I. Richards, *Consumer Miscomprehension and Deceptive Advertising: A Response to Professor Craswell*, 68 *B.U. L. Rev.* 431, 436–37 (1988).

adequate formatting.⁵⁵ In the literature on contract law, however, these issues are again conspicuous by their absence. More precisely, contracts scholars have long been aware of disclosure and format issues in connection with standard-form contracts, where much of the debate has concerned the extent to which consumers understand or are able to compare the effects of different sellers' boilerplate terms.⁵⁶ When it comes to the doctrines of misrepresentation and nondisclosure, however, the same issue is almost never noted. Scheppele, in her book-length (and otherwise quite sophisticated) treatment, does not discuss the actual format of any disclosure at all.⁵⁷ Ayres and Klass do a little bit better, as they acknowledge the issue in one footnote—but they apparently regard it as relevant only to situations involving mass advertisements, and hence inapplicable to disclosures made in face-to-face contracts.⁵⁸

As should by now be apparent, I believe this view to be too narrow. Many contracts are not negotiated face-to-face: Instead, they are negotiated by agents,⁵⁹ or through an exchange of standard forms, or (increasingly) by filling in forms online.⁶⁰ But even when two principals contract face-to-face, there are still limits on the total information that can be disclosed, so decisions must still be made as to just when any required disclosures must be given, and in what format the issues must be disclosed. (The proposed disclosure

⁵⁵ See, e.g., Latin, *supra* note 1, at 1220–42; Croley & Hanson, *supra* note 32, at 773–74, 778–79.

⁵⁶ See, e.g., Victor P. Goldberg, *Institutional Change and the Quasi-Invisible Hand*, 17 *J.L. & Econ.* 461, 462–63, 483–91 (1974); 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, 597–603 (1982); Alan Schwartz & Louis L. Wilde, *Imperfect Information in Markets for Contract Terms: The Examples of Warranties and Security Interests*, 69 *Va. L. Rev.* 1387, 1394–95 (1983); Craswell, *supra* note 5, at 49–50. Two recent articles have analyzed very similar effects under the rubric of behavioral law and economics. Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, 70 *U. Chi. L. Rev.* 1203, 1225–34 (2003); Oren Bar-Gill, *Seduction by Plastic*, 98 *Nw. U. L. Rev.* 1373, 1395–1408 (2004).

⁵⁷ See Scheppele, *supra* note 13.

⁵⁸ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 243 n.12 (discussing Craswell, *Interpreting*, *supra* note 51, at 716–19).

⁵⁹ On the differences between contracts between individuals and contracts between business firms, see Alan Schwartz & Robert E. Scott, *Contract Theory and the Limits of Contract Law*, 113 *Yale L.J.* 541 (2003).

⁶⁰ For a discussion of some issues raised by online contracting, see Budnitz, *supra* note 26; Radin, *supra* note 26.

of mortgage brokerage fees,⁶¹ for example, involved transactions that are very often consummated in person.) It is true that the precise details of the necessary tradeoffs will differ with the medium involved, so the form of disclosure most appropriate in a face-to-face negotiation is unlikely to be the same as the form of disclosure appropriate to a thirty-second TV ad. But even accounting for the differences between media, tradeoffs in formatting must still be attended to.

C. Absolute Versus Relative Information

One recurring design issue concerns the choice between information about the value of some existing product attribute, and information about potential *changes* or *differences* in that attribute. That is, some information (or some formats) may be particularly well suited to giving consumers information about the current value of some product attribute. But other measures of information, or other disclosure formats, may be better suited to communicating information about any changes in that attribute—either changes in the quality of a single seller's offerings, if that seller's quality improves or declines; or changes from one seller to another, if quality varies across sellers. As I discuss below, these two types of information can produce very different costs and benefits.

The difference between these types of information can be most easily seen in Professor George Akerlof's famous "market for lemons."⁶² In the extreme case, consumers have (a) perfect information about the prices offered by various sellers, (b) perfect information about the industry average level of quality, but (c) no information whatsoever about the quality offered by any individual seller. As a result, no individual seller has any incentive to offer high-quality products, because consumers—though they may recognize when average quality for the industry as a whole improves—will not be able to associate that improvement with any particular seller. Instead, every seller will have an incentive to save money by offering lower-quality products, for (under Akerlof's assumptions) consum-

⁶¹ See *supra* text accompanying note 52.

⁶² George A. Akerlof, *The Market for "Lemons": Quality Uncertainty and the Market Mechanism*, 84 Q.J. Econ. 488 (1970).

ers will not know which seller's quality has declined, even though they may perceive a decline in the industry as a whole.

The result, in Akerlof's model, is a steady deterioration of quality until every seller offers nothing but the lowest possible level of quality—in other words, a market with nothing but “lemons.”⁶³ Once this equilibrium is reached, consumers will still be perfectly informed about the quality of every product being offered, as long as consumers are still accurately informed about the average quality in the industry (since every product will by then have been degraded to the lowest possible quality). However, the market will be trapped in this inferior equilibrium due to the inability of consumers to recognize (and to properly reward) individual sellers who depart from that equilibrium by improving their product's quality. The problem in equilibrium, therefore, is not that consumers are inadequately informed about the existing levels of product quality, but rather that they would not be adequately informed about any changes from existing levels.⁶⁴

In regulatory settings, agencies are often concerned with improving buyers' information precisely in order to give sellers better incentives to improve the quality of their offerings.⁶⁵ As a result, the information and its format are often chosen with an eye toward improving buyers' *relative* information about sellers' offerings,

⁶³ Under the most extreme version of Akerlof's model, the lowest possible quality is worth less to buyers than it costs to produce, so no products are sold at all in the final equilibrium.

⁶⁴ For a more general model not tied to Akerlof's particular assumptions, see Michael Spence, *Consumer Misperceptions, Product Failure and Producer Liability*, 44 *Rev. Econ. Stud.* 561 (1977). In mathematical notation, if x measures the actual value of some attribute (for any individual seller) and $p(x)$ measures consumers' perception of that value, then $p'(x)$ represents the rate at which consumers' perceptions change when the actual value of x changes. The two questions addressed in the text thus correspond to asking (a) whether $p(x) = x$ at the current level of x , so that consumers accurately perceive the current value of the attribute; and (b) whether $p'(x) = 1$, so that consumers would accurately perceive the value of any change in that attribute. Both questions are of interest because the relation between $p(x)$ and x determines whether consumers make accurate choices given the products that sellers choose to produce, while the relationship between $p'(x)$ and 1 determines which products sellers will have an incentive to produce. Expressed in this notation, the Akerlof model represents the special case in which $p(x) = x$ in equilibrium, but $p'(x) = 1/n < 1$, where n is the number of firms in the market.

⁶⁵ See, e.g., *Nutrition Labeling: Use of “Healthy” and Similar Terms on Meat and Poultry Product Labeling*, 58 *Fed. Reg.* 688, 690 (Jan. 6, 1993); *Food Labeling: Format for Nutrition Label*, 57 *Fed. Reg.* 32058, 32069 (July 20, 1992).

without necessarily improving their information about *absolute* levels of quality. Of course, if buyers' information could be made perfect, these two goals would never conflict, because buyers who had perfect information about every individual seller would then be perfectly informed about the average quality as well. In the real world, though, perfect information is rarely possible (for all the reasons discussed earlier in Sections II.A and II.B)—which means that agencies may face a tradeoff between improving relative information and improving average information.

For example, the EPA's MPG ratings of different cars' fuel efficiency probably do not accurately represent the mileage that actual drivers can expect. In response to data showing that the ratings systematically overstated drivers' actual mileage, by 10% for city driving and 22% for highway driving, in 1984 the ratings were officially deflated by that amount.⁶⁶ Today, the ratings may again overstate the mileage that real drivers will attain as a result of increased congestion in cities, increased highway speed limits in the country, and the increased use of air conditioning practically everywhere.⁶⁷ Whether these discrepancies are significant, however, depends partly on what effects we expect the MPG ratings to produce. In particular, as long as the ratings accurately depict the *relative* efficiency of different models, they might still be perfectly adequate to give manufacturers an incentive to try to improve their cars' performance.

Of course, in the case of the MPG ratings, it might be possible to improve the ratings' absolute accuracy without in any way reducing the accuracy of their relative comparisons. In other contexts, however, the goal of improving relative comparisons has sometimes conflicted with the goal of improving absolute accuracy. For example, at various times the FTC has prohibited cigarette companies from advertising that their cigarettes were lower in tar or nicotine, or were otherwise less dangerous than competing brands. The FTC's concern was that such claims might reduce the accuracy of consumers' understanding of the absolute level of risk by leading

⁶⁶ Fuel Economy of Motor Vehicles: Revisions to Improve Fuel Economy Labeling and the Fuel Economy Data Base, 49 Fed. Reg. 13832, 13834 (Apr. 6, 1984) (codified at 40 C.F.R. pt. 600).

⁶⁷ Petition to Amend Fuel Economy Testing and Calculation Procedures; Request for Comments, 69 Fed. Reg. 16188, 16190 (Mar. 29, 2004).

them to underestimate the risks associated with smoking in general. Nevertheless, the effect of the prohibition was to remove a source of relative information about *differences* in risks across brands, thereby reducing firms' incentives to make marginal improvements in their tar and nicotine levels. Competition to improve tar and nicotine levels did not resume until the FTC reversed its position and allowed firms to advertise their actual tar and nicotine levels (as measured by the FTC).⁶⁸ Similar effects have been observed as the consequence of other restrictions, such as the Food and Drug Administration's ("FDA") prohibition of certain health claims.⁶⁹

Another advantage of presenting information in relative rather than absolute form is that it often gives some sellers their own incentive to publicize the information.⁷⁰ If all sellers must disclose the same information—for example, if all cigarette companies have to disclose the generalized warning that "cigarette smoking may be hazardous to your health"—then each company will want to minimize the effect of that warning by giving it as little prominence as possible. To be sure, government agencies usually try to combat this by regulating the format of the disclosure, as discussed in the preceding Section. But such formats are difficult to specify in every detail, and the companies will still have every incentive to make the warning as unnoticeable as the regulations allow.

By contrast, the companies' marketing incentives change if they can be rated on a *continuous* scale that reflects any difference or improvement in their product's quality. Companies that do poorly on such a rating will still try to minimize its impact—but companies that do well on the rating now have every incentive to advertise their success, thus giving the ratings far more publicity than could

⁶⁸ John E. Calfee, *Cigarette Advertising, Health Information and Regulation Before 1970*, Federal Trade Commission Bureau of Economics (Working Paper No. 134, 1985); Robert McAuliffe, *The FTC and the Effectiveness of Cigarette Advertising Regulations*, 7 *J. Pub. Pol'y & Marketing* 49 (1988).

⁶⁹ Pauline M. Ippolito & Alan D. Mathios, *Information and Advertising Policy: A Study of Fat and Cholesterol Consumption in the United States, 1977–1990* (Fed. Trade Comm'n, Bureau of Econ. Staff Report, 1996). For a more recent statement of the FDA's policy on disclosures to consumers, see Food and Drug Administration, *Guidance for Industry: Brief Summary: Disclosing Risk Information in Consumer-Directed Print Advertisements* (2004).

⁷⁰ Beales et al., *supra* note 2, at 527–28.

ever be mandated by regulation. In part for this reason, the FTC does not even require companies to disclose their cigarette tar and nicotine ratings; instead, it makes the ratings available, and allows those companies whose cigarettes are low in tar to publicize that fact. Similarly, while EPA mileage ratings do have to be disclosed in a point-of-sale document, most of the real-world impact of those ratings comes not from this required document, but rather from the much greater publicity those ratings receive in ads for high-mileage cars.

Of course, examples like these do not prove that relative information is *always* more useful than average or industry-wide disclosures. In some cases, for instance, any benefits that might be gained from marginal improvements in product quality might be swamped by the bad effects that might follow if the relative disclosures distorted consumers' understandings of overall product quality.⁷¹ Indeed, this was the FTC's original justification for banning comparative safety claims on behalf of allegedly "safer" cigarettes.⁷²

In other circumstances, there may be special reasons why sellers are unlikely to compete to improve the quality of their offerings along some particular dimension. For example, in the early 1980s the FTC considered requiring creditors to disclose more explicitly any remedies they might use against debtors who were late in repaying loans. One difficulty the FTC faced was that the remedies used by different creditors varied widely, from garnishment of wages and foreclosure on security interests to large late fees or harassing phone calls, and there appeared to be no way to construct a useful index (analogous to an appliance's Energy Efficiency Rating) that would measure the overall harshness of any particular creditor's remedies. In addition, though, the FTC also believed that creditors would be unlikely to compete to improve their rating on such an index because of an adverse selection problem. That is, creditors who score best on such an index (because their remedies

⁷¹ See, e.g., Jon D. Hanson & Kyle D. Logue, *The Costs of Cigarettes: The Economic Case for Ex Post Incentive-Based Regulation*, 107 *Yale L.J.* 1163, 1189–90 & nn.104–06 (1998).

⁷² See *supra* text accompanying note 68. On the other hand, in periods when the law did allow relative safety claims, it is possible that those claims themselves—that is, frequent and highly publicized claims saying, in effect, "our cigarettes are less risky than other brands"—may also have done a lot to remind consumers about the *average* riskiness of cigarettes. Calfee, *supra* note 68, argues for exactly this effect.

are in fact the least harsh) might be unwilling to publicize that fact, for fear of attracting precisely those borrowers who are most likely to default on their loans.⁷³

In short, the ideal balance between absolute and relative information is likely to vary with the facts of each case. My point, though, is that while this issue is often recognized in connection with regulatory disclosures, it is much less often raised in writings about the common law. Even in the field of products liability, where the attention to disclosure issues is greatest, the vast bulk of writing concerns consumers' perception of existing product risks—that is, do consumers under- or overestimate existing risks? By contrast, relatively little attention is paid to the accuracy of any *changes* in consumer perceptions in response to *changes* in actual riskiness.⁷⁴

In the contracts literature, unfortunately, this issue receives even less attention. It occasionally arises in connection with the enforceability of standard-form contracts, where an analogy to Akerlof's "market for lemons" has often been noted. That is, if consumers have perfect information about the prices offered by different sellers, and perfect information about the average effects of contract terms in sellers' standard forms, but if they have no information (or only poor information) about the effect of the contract terms used by any individual seller, each seller will then have an incentive to degrade the "quality" of its terms.⁷⁵ Indeed, the Supreme Court has recognized this possibility in antitrust cases involving contractual

⁷³ Credit Practices Rule; Statement of Basis and Purpose and Regulatory Analysis, 49 Fed. Reg. 7740, 7747 (Mar. 1, 1984). In this case, the FTC decided not to require increased disclosure, and instead adopted an outright ban on a smaller subset of creditor remedies that it believed were least justified. FTC Credit Practices Rule, 16 C.F.R. § 444 (2005).

⁷⁴ Using the mathematical notation introduced supra at note 64, and letting x represent the risks associated with some product, most torts scholars are very concerned with whether $p(x) = x$, but rarely if ever concerned with whether $p'(x) = I$. For some partial exceptions to this generalization, see Alan Schwartz, *Proposals for Products Liability Reform: A Theoretical Synthesis*, 97 *Yale L.J.* 353, 374–78 (1988); Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 *N.Y.U. L. Rev.* 630, 710–14 (1999). But even Hanson and Kysar seem interested in $p'(x)$ mostly for what it might imply about whether consumers accurately estimate existing risks (i.e., whether $p(x) = x$).

⁷⁵ See sources cited supra note 56.

tying requirements⁷⁶—though, interestingly, not in non-antitrust cases involving contract terms.⁷⁷

In any event, in discussions of misrepresentation or nondisclosure, this aspect of the information that might be disclosed is virtually never discussed. Most discussions focus on the issue raised by Anthony Kronman—should parties have to disclose information they obtained deliberately at their own expense?—and share Kronman’s casual conclusion that, if the information was not obtained at great expense, it should almost certainly be disclosed (as long as it is material).⁷⁸ To the extent that analysts specify the benefits of disclosure at all, they usually point to the role of information in helping people avoid a mistaken choice from among the alternatives then available on the market.⁷⁹ The possibility that better information might also improve the mix of goods and services actually produced by sellers—a proposition so central in many regulatory fields—is thus absent from most discussions of the common-law nondisclosure doctrine.

One reason for this omission may be a point noted earlier: The nondisclosure doctrine has not been used very aggressively, so courts and commentators have not often had to prioritize, or to think very hard about the exact details of what should be disclosed.⁸⁰ In addition, it may also be significant that the common-law

⁷⁶ See *Eastman Kodak Co. v. Image Technical Servs., Inc.*, 504 U.S. 451, 472–76 (1992) (expressing concern that customers might not be adequately informed about the full costs imposed by a tying requirement); *Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 13–15 (1984). I discuss this issue at more length in Richard Craswell, *Tying Requirements in Competitive Markets: The Consumer Protection Issues*, 62 *B.U. L. Rev.* 661, 671–79 (1982).

⁷⁷ See *Carnival Cruise Lines, Inc. v. Shute*, 499 U.S. 585, 596–97 (1991) (enforcing a forum selection clause in a cruise ship’s standard contract, without considering whether customers were adequately informed about the full costs imposed by that clause). In that case, the Court declined to consider “whether respondents had sufficient notice of the forum clause before entering the contract,” because the respondents had conceded in their brief that “the forum selection clause was reasonably communicated to the respondents, *as much as three pages of fine print can be communicated.*” *Id.* at 590 (emphasis added); see also *id.* at 597–98 (Stevens, J., dissenting).

⁷⁸ Kronman, *supra* note 4, at 12–14. As the principal thrust of Kronman’s article is to explain why information that is acquired at some expense should *not* necessarily be disclosed, he devotes only a few pages to the question of what to do with information that is freely or cheaply acquired.

⁷⁹ See, e.g., Michael J. Trebilcock, *The Limits of Freedom of Contract* 108, 112 (1993); Eisenberg, *supra* note 13, at 1654–55.

⁸⁰ See *supra* note 42 and accompanying text.

nondisclosure doctrine is applied to individual parties on a case-by-case basis, rather than to an entire industry through an administrative regulation. Consumers' use of comparative information is easiest when that information is presented in a similar format for all of the firms in an industry, but this sort of comparability may be hard to achieve in a decentralized court system. Thus, the argument for delegating such decisions to legislatures or administrative agencies, rather than to common-law courts, may have particular force with respect to relative or comparative information.⁸¹

III. LIABILITY FOR DECEPTION

The preceding Part of this Article described the costs and benefits that are relevant in assessing any disclosure requirement. Should this analysis change if one party to a contract, rather than merely failing to disclose some information, has affirmatively misrepresented something?

Misrepresentation—or fraud, to use the harsher term⁸²—is often regarded as worse than mere nondisclosure. After all, a party who fails to disclose some fact can be accused of failing to prevent an injury by remaining silent when she could have spoken, but fraud seems to involve the affirmative infliction of an injury. From the standpoint of many moral theories, affirmatively causing an injury is worse than merely failing to prevent one. And from an economic standpoint, misrepresentation can sometimes be prevented by saying less (by not making the fraudulent statement) rather than saying more (as in the case of affirmative disclosures). In other words, if we can isolate the bit or particle that conveyed the false information, and somehow remove that particle from the discourse, we may be able to eliminate the fraud *and* reduce overall communication costs, by reducing the number of bits or particles that need to be

⁸¹ See Beales et al., *supra* note 2, at 528; Schwartz & Wilde, *supra* note 56, *passim*.

⁸² Traditionally, fraud requires knowledge that one's representation is false, as well as an actual intent to deceive the defrauded party. By contrast, misrepresentation includes cases where the party charged with misrepresentation did not know that what she said was false ("innocent misrepresentation"), or where she had no intent to mislead the other party. While these distinctions are important for many purposes, they are only tangential to my interests here, so I will use the more inclusive term "misrepresentation."

communicated.⁸³ On this view of things, it is hardly surprising that prohibiting misrepresentation seems less controversial than requiring disclosure.

In practice, though, eliminating misrepresentation often involves more subtle costs. For example, if we require defendants to say *less*, in order to eliminate statements that might mislead parties, some of those prohibited statements may also convey truthful and useful information, which will be lost if the statements are prohibited. In other words, the quantized view is wrong when it assumes that false or inaccurate bits of information can always be separated from the truthful or valuable bits. This means that the cost of interfering with useful information is always potentially relevant, even in misrepresentation cases.

To be sure, sometimes it will be possible to preserve the true and valuable bits by requiring defendants to say *more*—that is, by allowing them to continue to make their original statements with the addition of further explanations or warnings, to reduce the risk that buyers will be misled by those statements. But these additional explanations or warnings often have costs of their own, including (as discussed in Part II) the cost of interfering with the communication of *other* truthful and useful information. The following Sections discuss these costs and benefits in more detail.

A. Misrepresentation in Federal Consumer Protection Law

While attention to costs and benefits is rare in the contracts literature, it is much more common in federal consumer protection law. This is especially true in litigation brought by the FTC under Section 5 of the Federal Trade Commission Act, which prohibits

⁸³ See Posner, *supra* note 9, at 110–13. Professor Michael Trebilcock makes a similar observation: “The case for such a rule [prohibiting fraud] would rest on a judgment that investments in fraudulent activity *have no positive social value* and that the absence of such a rule may induce socially wasteful investments by potential victims in avoidance precautions.” Trebilcock, *supra* note 79, at 104 (emphasis added).

Professor William Bishop has noted that it may be costly to eliminate misrepresentations if investigation is required to decide which facts are true and which are false (that is, to determine which statements are in fact *misrepresentations*). William Bishop, *Negligent Misrepresentation Through Economists’ Eyes*, 96 L.Q. Rev. 360 (1980). However, even Bishop implicitly assumes that, once the false statements have been identified, nothing further would be lost if those statements were to cease.

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“unfair or deceptive acts or practices,”⁸⁴ and in litigation brought by private parties under the Lanham Act, which prohibits the sale of products under any false description or representation.⁸⁵

Both of these statutes have long been interpreted as reaching *implied* misrepresentations as well as explicit ones. For example, Kraft once promoted the calcium content of its cheese slices, in contrast to the “imitation” slices sold by other brands, by saying:

I admit it. I thought of skimping. Could you look into those big blue eyes and skimp on her? So I buy KRAFT Singles. Imitation slices use hardly any milk. But KRAFT has five ounces per slice. Five ounces. So her little bones get calcium they need to grow.⁸⁶

In this case, it was perfectly true that Kraft used five ounces of milk per slice of cheese, while the rival brands did not. However, the FTC held Kraft liable for implicitly asserting that Kraft cheese slices had as much calcium as five ounces of milk (which was false, since some calcium was lost in processing). The FTC also ruled that the ads asserted that Kraft cheese slices had more calcium than the “imitation” slices (which was also false, since the imitation slices got calcium from sources other than milk). In short, the courts and the FTC have recognized that, even if no false claim is *explicitly* asserted, a seller can nevertheless be liable if its statements have the *effect* of misleading some of its audience.⁸⁷

At the same time, the courts and the FTC have also had to recognize that the effect of misleading one single consumer cannot be a sufficient ground for liability. After all, different consumers are likely to interpret sellers’ claims in different ways, so almost any claim (however truthful) might have the effect of misleading some consumer somewhere. Thus, the current legal standard holds that advertisements should not be interpreted as making a false claim unless they are likely to be interpreted that way by a “reasonable”

⁸⁴ 15 U.S.C. § 45(a)(1) (2000). (State consumer protection statutes, known as “little FTC acts,” often contain similar provisions.) While the distinction between “unfair” practices and “deceptive” practices can be significant for some purposes, I will not discuss that issue here, except for a brief reference *infra* at note 101.

⁸⁵ 15 U.S.C. § 1125(a)(1) (2000).

⁸⁶ *In re KRAFT, Inc.*, 114 F.T.C. 40, 122 (1991).

⁸⁷ *Id.* at 133–38.

consumer.⁸⁸ This test is of course a vague one, which leaves much to the FTC's or the courts' discretion.

In earlier decades, judges or FTC commissioners typically looked at each advertisement themselves, and made their own judgment about the ad's effect on consumers⁸⁹—a method that began to be questioned in the 1960s and 1970s.⁹⁰ Today, though, decisionmakers are likely to look to the *percentage* of consumers who interpret the ad as making any given claim, often relying on empirical tests (“copy tests”) that involve showing the disputed ad to a representative sample of consumers.⁹¹ To be sure, neither the courts nor the FTC have ever set a strict numerical cutoff, so that an ad would be illegal if $x\%$ of its audience interpreted it as making a claim that was false. But as long as the issue is framed in this way, it has proved to be very easy for the courts and the FTC to look to the relevant costs and benefits in deciding how to set that cutoff in any particular case.

For example, if the claim in question involves a very important product attribute—one which would cause customers serious injury if they were misled about it—then the ad is likely to be deemed illegal even if x is small: even if the ad misleads only a relatively

⁸⁸ FTC Policy Statement on Deception, *reprinted in* *In re Cliffdale Assocs.*, 103 F.T.C. 110 app. at 174–84 (1984). For a discussion of earlier case law, which suggested that the FTC might look to an advertisement's effect on consumers of low intelligence, see Ira M. Millstein, *The Federal Trade Commission and False Advertising*, 64 *Colum. L. Rev.* 439 (1964).

⁸⁹ See, e.g., *FTC v. Colgate-Palmolive Co.*, 380 U.S. 374, 391–92 (1965) (“Nor was it necessary for the Commission to conduct a survey of the viewing public before it could determine that the commercials had a tendency to mislead . . .”).

⁹⁰ See, e.g., Ernest Gellhorn, *Proof of Consumer Deception Before the Federal Trade Commission*, 17 *U. Kan. L. Rev.* 559, 563–72 (1969); Richard W. Pollay, *Deceptive Advertising and Consumer Behavior: A Case for Legislative and Judicial Reform*, 17 *U. Kan. L. Rev.* 625, 635–37 (1969); Robert Pitofsky, *Beyond Nader: Consumer Protection and the Regulation of Advertising*, 90 *Harv. L. Rev.* 661, 677–79 (1977).

⁹¹ For general discussions of this use of evidence see, for example, Janis K. Pappalardo, *The Role of Consumer Research in Evaluating Deception: An Economist's Perspective*, 65 *Antitrust L.J.* 793 (1997); J. Craig Andrews & Thomas J. Maronick, *Advertising Research Issues From FTC Versus Stouffer Foods Corporation*, 14 *J. Pub. Pol'y & Marketing* 301 (1995); Debra K. Owen & Joyce E. Plyler, *The Role of Empirical Evidence in the Federal Regulation of Advertising*, 10 *J. Pub. Pol'y & Marketing* 1 (1991); Thomas J. Maronick, *Copy Tests in FTC Deception Cases: Guidelines for Researchers*, 31 *J. Advertising Res.* 9 (1991); Ivan L. Preston, *Extrinsic Evidence in Federal Trade Commission Deceptiveness Cases*, 3 *Colum. Bus. L. Rev.* 633 (1987).

small percentage of its audience.⁹² On the other hand, if the only false impression an ad might convey concerns some much less important issue, the ad will not be deemed illegal unless it is shown to convey that impression to a larger fraction of its audience. In effect, the courts and the FTC apply a sliding scale, in which the number of consumers affected and the seriousness of their potential losses are both taken into account.⁹³

More significantly, the courts and the FTC at least occasionally consider the potential costs that might have to be incurred in order to prevent any false impression from being conveyed. That is, some false impressions might be avoided just by tweaking an advertisement's language slightly, without giving up anything in the way of useful information. Other false impressions might persist unless and until the ad is more radically altered. In recent years, the FTC and the courts have increasingly relied on empirical evidence based on actual *and alternative* versions of the challenged ads, which are each shown to a panel of consumers whose reactions are then tabulated. The difference between the results—that is, the number of consumers deceived by the original ad, *compared to* the number that are deceived even by the improved ad—gives a rough indication of how much of the original deception could feasibly have been avoided.⁹⁴

Moreover, in addition to the percentage of consumers whose deception could have been avoided, the FTC has occasionally considered the extent to which any *useful* information would be lost if the challenged advertisement had to be revised. For example, in one case a mail-order seller offered a mechanical device that it claimed would yield “significant improvements” in the fuel economy of a car. In fact, the device was unlikely to produce more than a very

⁹² See FTC Policy Statement on Deception, *reprinted in* *In re Cliffdale Assocs.*, 103 F.T.C. 110 app. at 174–84 (1984).

⁹³ I discuss this aspect of the case law at more length in Craswell, *Regulating*, *supra* note 51, at 551–62; and Craswell, *Interpreting*, *supra* note 51, at 681–714.

⁹⁴ I discuss this issue at greater length in Richard Craswell, “Compared to What?” *The Use of Control Ads in Deceptive Advertising Litigation*, 65 *Antitrust L.J.* 757 (1997). For other discussions of this use of “control ads,” see Pappalardo, *supra* note 91; David W. Stewart, *Deception, Materiality, and Survey Research: Some Lessons from Kraft*, 14 *J. Pub. Pol’y & Marketing* 15 (1995); Jacob Jacoby & George J. Szybillo, *Consumer Research in FTC Versus Kraft (1991): A Case of Heads We Win, Tails You Lose?* 14 *J. Pub. Pol’y & Marketing* 1 (1995).

small improvement, and even then only in extremely old cars. The FTC therefore ruled that the claim of “significant” improvements was deceptive, and enjoined its continued use.⁹⁵ In effect, the FTC decided that the potential benefit from the claim was so small (and the chance of misleading consumers was so great) that consumers as a class would be better off if this claim had never been made.

Two years later, however, the FTC addressed another case in which a seller had claimed that residential heat detectors offered a “significant” increase in safety over residential smoke detectors. In fact, heat detectors performed better than smoke detectors in only a few, highly unusual cases, and one expert testified that the extra protection provided in such cases was “marginal at best.”⁹⁶ In this case, however, the FTC ruled that the claim was not illegal because “[e]ven a very small amount of additional protection from death or serious injury caused by fire would no doubt be considered significant by some consumers.”⁹⁷ Thus, just as the FTC regularly considers the potential harm from deception on one side of the balance, it also considers the potential harm from reducing consumers’ information on the other side.

To mention just one more example, the FTC also applies an informal cost-benefit analysis in cases where the truth or falsity of a seller’s claim is uncertain—for example, in medical or technical areas where the underlying facts are not yet known. In particular, the FTC has ruled that most claims by a seller carry with them an implied claim that the seller has a “reasonable basis” for believing the claim to be true.⁹⁸ For example, under this doctrine it is not neces-

⁹⁵ *In re Cliffdale Assocs.*, 103 F.T.C. 110, 167–70 (1984). See also *In re Telebrands Corp.*, FTC Docket No. 9313 (Sept. 19, 2005), in which the FTC ruled against certain implied fitness claims on behalf of an electric “muscle stimulation belt,” in part because the belt apparently conferred no benefits whatsoever, so the ads could not have been conveying any useful information. *Id.* at 16–17. The FTC gave short shrift to the advertiser’s claim that its belts at least offered the benefit of a lower price than other, equally worthless belts. *Id.* at 18–19.

⁹⁶ *In re Figgie Int’l, Inc.*, 107 F.T.C. 313, 389 (1986).

⁹⁷ *Id.*; see also *id.* at 398 & n.4 (Bailey, Comm’r, concurring in part and dissenting in part) (arguing that the FTC should have required the seller to disclose additional material, to explain to customers that the incremental safety benefits, though real, were small).

⁹⁸ FTC Policy Statement Regarding Advertising Substantiation, *reprinted in* *In re Thompson Med. Co.*, 104 F.T.C. 648, app. at 839 (1984). While this doctrine is less well-established in private actions under the Lanham Act, similar theories have occasion-

sarily illegal to claim that a new pill will reduce the duration of colds, even if current scientific opinion is mixed concerning the pill's effectiveness. However, it would indeed be illegal if the current scientific opinion does not provide at least a "reasonable basis" for believing that the pill is effective—and it is up to the FTC to decide, in each case, what evidentiary basis would be "reasonable."

Significantly, the FTC's analysis of this issue explicitly looks to the relevant costs and benefits.⁹⁹ The range of possible solutions in this sort of case is more complex, for a seller in this situation might either (1) continue its claim only after conducting additional tests, and only if the tests support the claim; (2) continue its claim without additional tests, while adding disclosures explaining the level of scientific uncertainty; (3) withdraw its claim entirely; or (4) continue the claim unchanged. The value of the first solution—additional tests—depends both on the costs and the power of additional tests, so these are two factors the FTC considers. The value of the second solution—extra disclosures—depends on the ease or difficulty of communicating that information to consumers, including (as discussed in Part II) any costs that would follow if greater disclosure of the scientific uncertainties distracted consumers or otherwise diluted the impact of useful information. The costs of the third solution—withdrawing the claim—depend on how much consumers would lose if they were deprived of the claim: This turns on the benefits the product would have if the claim were true, discounted by the *ex ante* probability (insofar as it can be estimated) that the claim is true. Finally, the fourth solution—allowing the claim to continue unchanged—is optimal if the claim has too much potential value to be banned entirely, but neither of the first two solutions is more cost effective.

Of course, some cases pose much simpler issues, in which the cost-benefit analysis is trivially easy. For example, if a seller says

ally been employed in those cases. See, e.g., *Proctor & Gamble Co. v. Chesebrough-Pond's, Inc.*, 747 F.2d 114, 119 (2d Cir. 1984); *Thomson Med. Co. v. Ciba-Geigy Corp.*, 643 F. Supp. 1190, 1200 (S.D.N.Y. 1986); *Am. Home Prods. Corp. v. Abbott Labs.*, 522 F. Supp. 1035, 1043 (S.D.N.Y. 1981).

⁹⁹ For a more general discussion of this issue, see Craswell, *Interpreting*, *supra* note 51, at 709–14; John E. Calfee & Janis K. Pappalardo, *How Should Health Claims for Foods be Regulated? An Economic Perspective*, *Economic Issues* (Fed. Trade Comm'n Bureau of Econ.), Sept. 1989.

“my product will cure cancer,” when in fact it won’t, it will usually be easy to conclude that society would be better off if the seller stopped making that statement. The statement is unlikely to produce any benefits, absent highly unusual circumstances; and it is potentially harmful if it leads people to spend money on a worthless “cure.” In such a case, then, the outcome of the cost-benefit analysis is so obvious that the analysis may seem invisible, or even unnecessary.

Perhaps as a result, even in the regulatory arena, the relevant costs and benefits are not recognized as often as one might like. The moral taint associated with “fraud” and “misrepresentation” sometimes continues to play a role, and occasionally it is denied that costs and benefits matter at all. For example, the FDA was historically reluctant to permit any health claims concerning food—especially claims regarding health benefits whose truth was still a matter of scientific controversy—out of a belief that consumers would necessarily be deceived, though this policy now appears to be changing.¹⁰⁰ Similarly, the FTC has only rarely given *explicit* recognition to its balancing of costs and benefits, at least in cases where deception is alleged.¹⁰¹ One former FTC commissioner even

¹⁰⁰ For a discussion of this history, see Calfee & Pappalardo, *supra* note 99. In 1999, an appellate court held that the First Amendment did not permit the FDA to ban claims that were potentially deceptive, unless the FDA first determined that it was impossible for additional disclosures to eliminate or reduce the deception while preserving the benefits of any useful information. *Pearson v. Shalala*, 164 F.3d 650, 657–58 (D.C. Cir. 1999). In 2002, the FDA responded by adopting a more flexible policy similar to the FTC’s “reasonable basis” policy. Food and Drug Administration, *Guidance for Industry and FDA: Interim Procedures for Qualified Health Claims in the Labeling of Conventional Human Food and Human Dietary Supplements* (July 2003).

¹⁰¹ The most explicit recognition of the need to balance costs and benefits appears in FTC Policy Statement Regarding Advertising Substantiation, *reprinted in* *In re Thompson Med. Co.*, 104 F.T.C. 648, app. at 839–42 (1984). The FTC has also explicitly recognized the need to balance costs and benefits when exercising its authority to prohibit “unfair” acts or practices, which is legally distinct from its authority to prohibit “deceptive” acts or practices. FTC’s Letter to Senate Subcommittees on Bill to Restrict Agency’s Jurisdiction over Professionals and Unfair Acts or Practices, *reprinted in* 42 *Antitrust & Trade Reg. Rep.* 568, 568–70 (1982). The requirement of cost-benefit analysis in “unfairness” cases was subsequently codified at 15 U.S.C. § 45(n) (2000).

Ironically, one legacy of this distinction (as described by a former director of the FTC’s Bureau of Consumer Protection) is that FTC attorneys sometimes prefer to plead deception (rather than unfairness) in their complaints, in the hope of avoiding cost-benefit analysis. J. Howard Beales, *The Federal Trade Commission’s Use of Un-*

asserted that “once we have found that conduct is deceptive we simply enjoin it, without attempting to balance the degree of injury against the value of the information to those consumers fortunate enough not to be misled by it.”¹⁰²

However, statements like these are logically similar to statements like, “once courts have found that conduct is negligent, they do not consider the costs and benefits of further precautions.” That is, it may not be permissible to argue that *negligent* behavior has benefits that outweigh its costs, but this is because a good deal of cost-benefit analysis usually goes into deciding whether any challenged behavior is, in fact, negligent. On the view I have argued for, the same is true of labels like misrepresentation or deception.

*B. Misrepresentation and Pragmatics*¹⁰³

Interestingly, similar tradeoffs have also been recognized in linguistics and the philosophy of language, especially by scholars working on what has come to be called “pragmatic interpretation.” These scholars have long recognized that information is sometimes conveyed without ever being explicitly (or semantically) asserted. For example, if someone asks how I feel and I pull out a bottle of cold medicine and show it to them, I will have effectively communicated that I have a cold, even without explicitly asserting that fact.¹⁰⁴ Similarly, if someone tells me his car is out of gasoline, and I reply that there is a gas station three blocks away, I will usually be taken as implying that the gas station is still in business.¹⁰⁵

One theory, first advanced by Professor Paul Grice, suggests that many of these pragmatic implications (or “conversational implica-

fairness Authority: Its Rise, Fall, and Resurrection, 22 J. Pub. Pol’y & Marketing 192, 195 (2003).

¹⁰² George W. Douglas & Neil W. Averitt, FTC Rationalizes Consumer Protection Mission, *Legal Times*, Mar. 11, 1985, at 11; see also *In re Int’l Harvester Co.*, 104 F.T.C. 949, 1056 (1984) (“Deception[.] . . . unlike some other practices we are called upon to review, never offers increased efficiency or other countervailing benefits that must be considered.”).

¹⁰³ This subsection draws heavily on an earlier article of mine, Richard Craswell, *Do Trade Customs Exist?* in *The Jurisprudential Foundations of Corporate and Commercial Law* 118, 129–32 (Jody S. Kraus & Steven D. Walt eds., 2000).

¹⁰⁴ This example is taken from Dan Sperber & Deirdre Wilson, *Relevance: Communication and Cognition* 25–26 (1986).

¹⁰⁵ This example is taken from Paul Grice, *Logic and Conversation*, reprinted in *Studies in the Way of Words* 22, 32 (Paul Grice ed., 1989) [hereinafter *Studies*].

tures,” as Grice termed them) could be derived by assuming that speakers were following the Cooperative Principle: “Make your conversational contribution such as is required, at the stage at which it occurs, by the accepted purpose or direction of the talk exchange in which you are engaged.”¹⁰⁶ Grice also formulated more specific maxims that he saw as implications of the Cooperative Principle—for example, “Make your contribution as informative as is required (for the current purposes of the exchange),” “Be brief,” and “Do not say that for which you lack adequate evidence.”¹⁰⁷ Grice’s thesis was that the information conveyed pragmatically by any utterance is the information that would have to be true in order to rule out what would otherwise be a violation of these maxims.

For example, consider the utterance about the gas station three blocks away, made to a person who both parties know to be in need of gas. A speaker who made such an utterance while knowing that the gas station was out of business would be violating the maxim requiring him to be as informative as necessary, as well as another maxim requiring him to be relevant. But there would be no such violation if the speaker knew that the gas station was still in business, because in that case the utterance would be both informative and relevant. This, Grice said, explains why virtually everyone who hears such an utterance would assume that the speaker did know the gas station was still in business (or, at least, that the speaker had no knowledge that it had gone out of business).¹⁰⁸ Some legal scholars have therefore suggested that Gricean principles could be used as guides to interpretation, especially in areas of law concerned with misrepresentation by implication or by half-truth.¹⁰⁹

Indeed, just such an analysis could explain why the Kraft cheese advertisement described earlier was judged deceptive by the

¹⁰⁶ *Id.* at 26.

¹⁰⁷ *Id.* at 26–27.

¹⁰⁸ *Id.* at 32.

¹⁰⁹ See, e.g., Peter Meijes Tiersma, *The Language of Perjury: “Literal Truth,” Ambiguity, and the False Statement Requirement*, 63 *S. Cal. L. Rev.* 373, 383–84 (1990) (applying Grice’s analysis to perjury); Donald C. Langevoort & G. Mitu Gulati, *The Muddled Duty to Disclose Under Rule 10b-5*, 57 *Vand. L. Rev.* 1639, 1645–46 (2004) (applying it to securities law); Craswell, *Interpreting*, *supra* note 51, at 716–19 (applying it to the law of false advertising).

FTC.¹¹⁰ After all, when Kraft's advertisement says that its cheese uses five ounces of milk for every slice, Grice's Cooperative Maxim would be violated unless that fact—the amount of milk per slice—had some relevance to consumers. Thus, on Grice's analysis, consumers might be within their rights to supply that relevance by making some additional inference, such as the inference that each slice of cheese contained *as much calcium* as five ounces of milk. On the facts of the case, though, this inference was false, because some of the calcium was lost during the production process. In this way, a statement can mislead even without explicitly asserting a false claim, if it triggers a false conversational implicature.

However, while Grice's maxims may fit many cases of misrepresentation, they do not eliminate the need for the tradeoffs discussed in this Article. Instead, as many pragmaticists have pointed out, Grice's maxims are often vague, and could even be contradictory as applied to any given case.¹¹¹ As a result, any actual application of the Gricean maxims will usually require close attention to the tradeoffs described above.

For example, suppose that a speaker says that there is a gas station three blocks away (to someone who is known to be in need of gasoline), but fails to mention the brand of gasoline, its price, or the name of the gas station's owner. Does the speaker's silence on these points pragmatically imply that the speaker lacks any information about these topics? If the maxim of informativeness required speakers to disclose every fact known to them, then (under Grice's theory) the speaker's silence would imply he lacked the information, since a speaker who knew such information but failed to disclose it would be violating this version of the maxim of informativeness. In fact, though, Grice did not believe that the maxim of informativeness was this demanding, for his other maxims enjoin the speaker to be relevant, to be brief, and not to make the contribution any more informative than is required. In order to apply Grice's maxims in any particular context, then, tradeoffs will be required between the goals that each of the maxims serve.

¹¹⁰ Supra text accompanying note 87.

¹¹¹ See, e.g., Sperber & Wilson, supra note 104, at 36–37; Jerrold M. Sadock, On Testing for Conversational Implicature, in 9 *Syntax and Semantics: Pragmatics* 281, 285–86 (Peter Cole ed., 1978).

Moreover, at least some of the tradeoffs required by Grice's maxims could be described as a form of cost-benefit analysis. For example, one way to determine what information must be disclosed in order to be "as informative *as required*" is by reference to the value that any given piece of information would have to the listener. That value could then be compared to the cost of explicitly disclosing that information, both in terms of prolonging the conversation and (in some cases) in terms of possibly distracting the listener from other, more important matters. Indeed, Grice himself analyzed the tension between informativeness, brevity and relevance in just these terms. He noted that listeners do not always draw inferences about the speaker's lack of knowledge just because certain information has been omitted, and suggested that this makes sense if "the gain [from mentioning the information] would have been insufficient to justify the additional conversational effort."¹¹² If "gain" is measured by the importance of the information to a seller's customers, and "conversational effort" is measured by the extent to which the new information would interfere with other important information or create new ambiguities of its own,¹¹³ then this is exactly the balance that I have been concerned with here.

A similar tension can arise between the duty to be as informative as required and another of Grice's suggested maxims: "Do not say that for which you lack adequate evidence."¹¹⁴ The latter maxim can explain why an unqualified assertion implies pragmatically that the speaker has adequate evidence in support of the assertion; otherwise, the speaker would be violating the maxim about adequate evidence. However, it is hard to define how much evidence is "adequate" without making some kind of tradeoff in the nature of a cost-benefit analysis. If the information about the gas station three blocks away would be extremely valuable if true—for example, if there is no other source of gasoline within fifty miles—the speaker might then be justified in mentioning that gas station even if there

¹¹² Paul Grice, *Further Notes on Logic and Conversation*, reprinted in *Studies*, supra note 105, 41–42.

¹¹³ Grice, *Logic and Conversation*, reprinted in *Studies*, supra note 105, at 26–27. ("[O]verinformativeness may be confusing in that it is liable to raise side issues; and . . . in that the hearers may be misled as a result of thinking that there is some particular *point* in the provision of the excess of information.") (emphasis in original).

¹¹⁴ *Id.* at 27.

were only a slight chance that it was still open for business. But if there is another gas station only slightly farther away in the opposite direction, and this second gas station is known to be open for business, that could suggest that the speaker should not have mentioned the first gas station unless he was absolutely sure that it, too, was open.¹¹⁵ In other words, the amount of certainty needed to justify an assertion—and, hence, the evidence that an assertion pragmatically presupposes—would seem to depend on a balance between the value the asserted information would have if true, and the potential harm that would be caused if the assertion turns out to be false.¹¹⁶

This similarity between cost-benefit tradeoffs and pragmatic implications is not coincidental. Grice himself suggested that his Cooperative Principle could be thought of as “a quasi-contractual matter” with parallels to any other cooperative enterprise, even those not involving interpretation or speech.¹¹⁷ Indeed, the Cooperative Principle itself—“make your conversational contribution such as is required by the accepted purpose or direction of the talk”—could be thought of as a commitment to maximizing the expected value of their conversation, just as economists speak of maximizing the expected value of a transaction or of a business enterprise. To be sure, the exact nature of the costs and benefits being traded off (to say nothing of their respective magnitudes) is often difficult to assess in speech situations. Still, scholars who have modeled pragmatic implications more formally than Grice have had to incorporate such tradeoffs into their models explicitly. As Atlas and Levinson put it, informativeness (in the Gricean sense) is “part of an account of efficient communicative behavior.”¹¹⁸

¹¹⁵ In either situation, a possible alternative is for the speaker to try to describe the evidentiary basis for his beliefs, thereby letting the other party decide for herself which gas station to try first. The attractiveness of this alternative depends on how easily the speaker’s evidentiary basis can be communicated—in other words, it depends on the optimal balance between being informative and being brief, as analyzed in the preceding paragraph.

¹¹⁶ Compare the FTC’s requirement that advertisers possess a reasonable evidentiary basis for any assertions they make in ads. See *supra* note 98 and accompanying text.

¹¹⁷ Grice, *Logic and Conversation*, reprinted in *Studies*, *supra* note 105, at 29.

¹¹⁸ Jay David Atlas & Stephen C. Levinson, *It-Clefts, Informativeness, and Logical Form: Radical Pragmatics (Revised Standard Version)*, in *Radical Pragmatics* 1, 50

C. Misrepresentation in Contract Law

In contrast to these other fields, contracts scholarship has devoted little attention to issues of misrepresentation.¹¹⁹ The prevailing view, as noted earlier, seems to be that misrepresentation presents a strong and uncontroversial case for liability.¹²⁰ For example, while there is much disagreement about when burdensome contract terms should be set aside under the doctrine of unconscionability, even the strongest critics of unconscionability agree that some remedy is justified if a seller has misrepresented the terms of her contract.¹²¹

As a consequence, contracts scholars have also devoted little (if any) attention to the question of what should *count* as a misrepresentation. The Second Restatement, for example, states straightforwardly that a misrepresentation is “an assertion that is not in accord with the facts.”¹²² But when it comes to determining what any given representation actually asserts, the authors of the Restatement can say only—correctly, but not very helpfully—that it “depends on the meaning of the words in all the circumstances, including what may fairly be inferred from them.”¹²³ On the question of just which inferences may be drawn in any given circumstance, though, the Restatement (and contract-law scholarship) offers little guidance.¹²⁴ And while a good deal of attention has been paid in recent years to the subject of default rules, or the rules used to find

(Peter Cole ed., 1981); see also Sperber & Wilson, *supra* note 104, at 123–32; Asa Kasher, *Gricean Inference Revisited*, 29 *Philosophica* 25, 31–40 (1982).

¹¹⁹ Rare exceptions include Ayres & Klass, *Insincere Promises*, *supra* note 15, and Randy E. Barnett & Mary E. Becker, *Beyond Reliance: Promissory Estoppel, Contract Formalities, and Misrepresentations*, 15 *Hofstra L. Rev.* 443, 485–95 (1987). For a useful discussion of a related issue—the extent to which contracting parties should be allowed to opt out of the rules against fraud or misrepresentation—see Kevin Davis, *Licensing Lies: Merger Clauses, the Parol Evidence Rule and Pre-Contractual Misrepresentations*, 33 *Val. U. L. Rev.* 485 (1999).

¹²⁰ See, e.g., Posner, *supra* note 9; Davis, *supra* note 119, at 497–98.

¹²¹ See, e.g., Richard A. Epstein, *Unconscionability: A Critical Reappraisal*, 18 *J.L. & Econ.* 293, 298–99 (1975). Significantly, Epstein regards mere nondisclosure as presenting a much more problematic case for judicial intervention. *Id.*

¹²² Restatement (Second) of Contracts § 159 (1981).

¹²³ *Id.* § 159 cmt. a. The same comment adds that an assertion “may also be inferred from conduct other than words.” *Id.*

¹²⁴ For a somewhat similar criticism of the doctrine governing misrepresentation and fraud in securities law, see Donald C. Langevoort, *Half-Truths: Protecting Mistaken Inferences by Investors and Others*, 52 *Stan. L. Rev.* 87 (1999).

implied terms in actual contracts,¹²⁵ there has been almost no attention given to the question of when to find implied representations (or implied *misrepresentations*) in parties' extra-contractual assertions.

1. Misrepresentation in Hoffman v. Red Owl?

As an example, consider the well-known case of *Hoffman v. Red Owl Stores*.¹²⁶ Red Owl, which franchised grocery stores, encouraged Hoffman to sell his bakery and to take various other steps (including moving to another city to get some experience running a grocery) in the hope of being awarded a Red Owl franchise. After several times assuring Hoffman that the franchise would be forthcoming, Red Owl eventually decided not to grant him the franchise, for reasons that were never explained. The Wisconsin Supreme Court held Red Owl liable for Hoffman's reliance expenditures, based on what was then a somewhat novel theory of promissory estoppel.¹²⁷

While the promissory estoppel theory attracted a good deal of discussion in its own right,¹²⁸ some commentators have suggested that Red Owl's liability might better be seen as resting on misrepresentation. On this view, Red Owl was properly held liable because it misrepresented either (1) the actual probability that a

¹²⁵ See, e.g., Ian Ayres & Robert Gertner, Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules, 99 Yale L.J. 87, 113–14 (1989). Other discussions of this issue include Charles J. Goetz & Robert E. Scott, The Limits of Expanded Choice: An Analysis of the Interactions Between Express and Implied Contract Terms, 73 Cal. L. Rev. 261 (1985); Jason Scott Johnston, Strategic Bargaining and the Economic Theory of Contract Default Rules, 100 Yale L.J. 615 (1990); Robert E. Scott, A Relational Theory of Default Rules for Commercial Contracts, 19 J. Legal Stud. 597 (1990); Randy E. Barnett, The Sound of Silence: Default Rules and Contractual Consent, 78 Va. L. Rev. 821 (1992); Alan Schwartz & Robert E. Scott, Contract Theory and the Limits of Contract Law, 113 Yale L.J. 541, 594–609 (2003); and the articles of the Symposium on Default Rules and Contractual Consent, 3 S. Cal. Interdisc. L.J. 1 (1993).

¹²⁶ 133 N.W.2d 267 (Wis. 1965).

¹²⁷ *Id.*

¹²⁸ See, e.g., Stanley D. Henderson, Promissory Estoppel and Traditional Contract Doctrine, 78 Yale L.J. 343 (1969); Charles L. Knapp, Enforcing the Contract to Bargain, 44 N.Y.U. L. Rev. 673 (1969); Jay M. Feinman, Promissory Estoppel and Judicial Method, 97 Harv. L. Rev. 678 (1984); E. Allan Farnsworth, Precontractual Liability and Preliminary Agreements: Fair Dealing and Failed Negotiations, 87 Colum. L. Rev. 217, 236–39 (1987).

franchise would be granted to Hoffman, or (2) its own intentions, if it strung Hoffman along while never intending to give him a franchise.¹²⁹ And while it is of course possible that Red Owl was guilty of misrepresentation, the case is far from easy.

Consider, for example, the theory that Red Owl misrepresented the actual probability that a franchise would be awarded. To be sure, Red Owl never quoted any numerical probability, but the Red Owl representatives did say things like “[e]verything is ready to go,” and there would be “no problems” in getting Hoffman a franchise.¹³⁰ Would a reasonable franchisee (to use the FTC’s test) interpret such language as representing a 100% probability that Hoffman would be granted a franchise, with no possibility of any slip? Or would they instead interpret it as a representation of some slightly lower probability—say, 99%, or 95%, or 90%?¹³¹ And in that case, was the ex ante probability of a franchise in fact less than 99%, or 95%, or whatever interpretation we assign to Red Owl’s statements? With hindsight, of course, we know that the franchise was *not* granted in this case—but that does not tell us whether the ex ante probability was high or low.

In addition, even if the ex ante probability of a franchise was indeed less than Red Owl represented it to be, or less than what Hoffman could reasonably have interpreted their statements as representing, we still need to consider what (if anything) Red Owl should have said instead. For instance, would it have been enough to have said only slightly less, by not making the statements quoted above? (In that case, what probability would Hoffman have implicitly estimated, and would that estimate have been any more accurate?) Or should they have gone even further in the direction of saying less, and not even have held out the prospect of a franchise? Possibly, if the probability of the franchise ever materializing was

¹²⁹ See, e.g., Ayres & Klass, *Insincere Promises*, supra note 15, at 148–49; Barnett & Becker, supra note 119, at 489–91; Mark P. Gergen, *Liability for Mistake in Contract Formation*, 64 S. Cal. L. Rev. 1, 34 (1990).

¹³⁰ *Red Owl*, 133 N.W.2d at 269–70.

¹³¹ In other contexts, Ayres and Klass discuss the possibility of a default interpretation that the probability of performance be sufficiently high to make it worth the promisee’s while to rely, Ayres & Klass, *Insincere Promises*, supra note 15, at 39–42, and a default interpretation that the probability of performance be at least fifty percent, *id.* at 99–104. Nothing in *Red Owl* tells us whether the ex ante probability of a franchise exceeded either of these two benchmarks.

so low that nothing would be lost by eliminating that prospect—but nothing in the court’s opinion supports that conclusion, either.

Alternatively, maybe it would have been better for Red Owl to say *more*, by holding out the prospect of a franchise but telling Hoffman honestly what his chances of getting it were. In that case, though, a different set of questions has to be asked, analogous to the ones asked in Part II about other disclosure requirements. For example, what precisely should Red Owl have disclosed about that probability? How prominent should they have made the disclosure, to get Hoffman or other potential franchisees to pay attention to it? And what other information, if any, might that disclosure have crowded out?¹³² As these questions indicate, a finding that Red Owl may have misled Hoffman is simply not sufficient to decide that Red Owl necessarily should have said something other than what it did.

Similar difficulties arise under the theory that Red Owl may have misrepresented its intentions toward Hoffman. To be sure, Red Owl never explicitly said anything about its own intentions, but Ayres and Klass point out that many promises can plausibly be interpreted as representing that the promisor does, in fact, intend to perform.¹³³ As one English judge famously put it, “the state of a man’s mind is as much a fact as the state of his digestion”¹³⁴—so if Red Owl misrepresented the state of its mind, that could provide another basis for liability.

However, this theory has its difficulties as well. Even if we accept, for the sake of argument, that corporate entities can have intentions, and even if we accept that Red Owl’s assurances in this case represented something about those intentions, we still need to decide precisely what it was they represented. Ayres and Klass consider various possible default interpretations—for example, a promise might be taken to imply that the promisor affirmatively intends to perform, or at least that the promisor does not affirma-

¹³² For the FTC’s decision about what information franchisors in general ought to disclose to potential franchisees, see Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures, Trade Regulation Rule, 43 Fed. Reg. 59614 (Dec. 21, 1978) (codified at 16 C.F.R. § 436.1).

¹³³ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 21–25.

¹³⁴ *Edgington v. Fitzmaurice*, (1885) 29 Ch.D. 459, 483 (Ch. App.) (Bowen, L.J.).

tively intend not to perform.¹³⁵ But even if we also accept one of these possibilities as a reasonable interpretation of Red Owl's assurances, we still do not have a misrepresentation unless Red Owl in fact intended something different than what it represented. In other words, even after we have decided how to interpret Red Owl's implicit representation of its intention, we still have to decide what Red Owl's intention actually was.

The problem, in this case, is that Red Owl had no reason to string Hoffman along if it intended from the beginning to desert him, so there is no reason to suppose that Red Owl *never* intended to perform. Instead, Red Owl's intention (again, to the extent that a corporate entity can even have an intention) may well have been closer to one or more of these:

- (1) We intend to grant you the franchise unless it no longer looks like a good deal to us at the time.
- (2) We intend to grant you the franchise unless something unusual happens to the market.
- (3) We intend to grant you the franchise unless one of the following six things happens.

If one or more of these is what Red Owl actually intended, then was it false for them to implicitly represent that they "intended to perform"?

As Ayres and Klass recognize, these difficulties involved in defining a promisor's intention (for purposes of a claim that the promisor misrepresented its true intent) go deeper than the specific facts of *Red Owl*. That is, describing any promisor as "intending not to perform," or even as "failing to have an affirmative intention to perform" will almost always be problematic, for most promisors have conditional intentions.¹³⁶ Even the most honest promisor, for instance, might acknowledge that she would break her promise if a sufficiently large inducement were to materialize (A \$10 million offer from Bill Gates? A chance to eliminate world poverty?). Similarly, even the most dishonest scoundrel could always claim that

¹³⁵ Ayres & Klass, *Insincere Promises*, supra note 15, at 21–26.

¹³⁶ *Id.* at 26–29.

she fully intended to perform if certain unlikely but conceivable conditions were met (for example, if Bill Gates suddenly offered her \$10 million to perform her contract). In some sense, then, almost every promisor intends both to perform her promise in some states of the world, and not to perform it in others.

Once this is seen, it is difficult even to define what it would mean for a promisor to have “never intended to perform.” The voluminous literature on conditional intentions in criminal law and in the philosophy of mind confirms the difficulty of drawing such lines, even on a purely conceptual basis.¹³⁷ While Ayres and Klass acknowledge this difficulty, their only solution is to posit a vague “range of mutual expectations” about what kinds of conditions are permissible and which are not, and to note that “context plays a large role” in determining the exact scope of that range.¹³⁸ They do suggest that conditions designed to increase the promisor’s gains may be less permissible than conditions designed to protect the promisor from losses—but they note that the relevance of this line, too, will depend on the context. Recognizing the difficulty of these issues, Ayres and Klass then proceed (wisely, in my view) to focus on misrepresentations about the actual probability of performance, rather than on misrepresentations about the promisor’s supposed intentions.¹³⁹

Still, let us set these difficulties aside, and assume that Red Owl’s true intentions (whatever those were) were in fact at odds with what Red Owl’s assurances implicitly represented about its intentions (whatever that might be). Even then, it still does not follow that Red Owl necessarily should be held liable for misrepresentation. Instead, we still need to consider whether it really would have been better if Red Owl had instead said anything other than what it actually said.

Indeed, by now the relevant questions should be familiar. Should Red Owl have said *less*, by not representing anything about its in-

¹³⁷ For a recent survey of this literature, see Gideon Yaffe, *Conditional Intent and Mens Rea*, 10 *Legal Theory* 273 (2004).

¹³⁸ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 27–28.

¹³⁹ *Id.* at 27–29. For further discussion of Ayres and Klass’s treatment of a promisor’s intentions, see Aditi Bagchi, *The Accidental Promise: Remaking the Law of Misrepresented Intent* (2005) (book review) (unpublished manuscript, on file with the Virginia Law Review Association). I will return to this point *infra* in Part V.

tentions? If representations about Red Owl's intentions are inferred from the very fact that it offered Hoffman a franchise, then the only way Red Owl could have said less would have been to not offer the franchise at all, and that would have eliminated any chance whatsoever for Hoffman to get the franchise. (Though if the chance of receiving a franchise was sufficiently small, maybe Hoffman would indeed have been better off if Red Owl had never offered it.) Alternatively, perhaps the best solution would have been for Red Owl to say *more*, by offering the franchise but providing additional information about the probabilities or conditions under which it would refuse to go through with the deal. To assess that possibility, though, we need to think about precisely what Red Owl might have disclosed, with what degree of prominence, and with what degree of interference with any other information that might have been communicated. In other words, to assess the desirability of having Red Owl say more, we need to consider all the issues discussed earlier in Part II. This is the sense in which even misrepresentation cases cannot be assessed without attending to the costs and benefits.

2. *Misrepresentation by Yale University?*

As another example, consider Ayres and Klass's perhaps provocative suggestion that Yale may have committed fraud when it promised (by accepting applications and tuition money) to provide education and dormitory services during 1984. Allegedly, Yale accepted applications with the knowledge that there was a significant chance of a strike by clerical and technical workers, thus reducing the probability that students would be able to receive a full measure of services.¹⁴⁰ Ayres and Klass do not attempt to estimate the ex ante probability that Yale would in fact have been able to perform, nor do they identify the exact probability that was (implicitly) asserted by Yale's promises. Still, let us take their example at face value, and stipulate that Yale's promise of educational services misrepresented the probability that its students would in fact receive the offered services.

If saying less were *always* the best solution to misrepresentation, this would imply that Yale should not have offered educational ser-

¹⁴⁰ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 163–64.

vices during 1984. After all, on Ayres and Klass's analysis, it was precisely Yale's offer of educational services that gave rise to the implied misrepresentation, so one way to eliminate the misrepresentation would have been to eliminate the offer. However, this solution would have *guaranteed* that no educational services would have been provided during 1984, thus eliminating any possibility of a benefit to those students who would have found it inconvenient or impossible to transfer to another school. As long as there was a significant probability that Yale would be able to perform—that is, that the strike would be averted, or that it would be short and non-disruptive—one suspects that these students would have preferred to have Yale continue to offer its educational services. The point is one that has also been made by Professor Kevin Davis: Even promises whose performance is unlikely can still have social value, as long as there is *some* chance that they might be performed. As a consequence, we should be wary of deterring the making of those promises.¹⁴¹

Of course, Ayres and Klass do not recommend that Yale should have shut down for a year, for they do not believe that the only way to avoid misrepresentations is to say less. Instead, they conclude that Yale should have said *more*: Yale should have disclosed to potential students the probability of a disruptive strike.¹⁴² This way, Yale could continue to offer its services for the benefit of any students who are willing to take their chances, while students with the option of going elsewhere could make a better-informed decision about whether to do so.

However, once additional disclosure is identified as the preferred solution, the case then becomes (for all practical purposes) a case of nondisclosure rather than a case of simple misrepresentation. As a result, all of the issues discussed in Part II become relevant again. For example, was information about the potential strike sufficiently important to be worth the costs of disclosing? In particular, was it the most beneficial information that Yale could have disclosed? (What about disclosing the crime rate in New Haven, or disclosing which professors intend to be on leave in 1984?) Could better disclosure about any of these attributes intensify the compe-

¹⁴¹ Davis, *supra* note 18, at 541–44.

¹⁴² Ayres & Klass, *Insincere Promises*, *supra* note 15, at 163.

tition between Yale and other leading universities, by making it easier for students to see which schools were subject to the greatest risks? If so, which of these attributes would be *most* likely to trigger competitive improvements? In any case, we would also have to specify a particular format and a particular stage in the admissions process at which these disclosures should have been made. (If some of the information is already publicly available in a library, should *that* be a sufficient disclosure? Or would it be better to require the information to be disclosed in a more accessible format, somewhere in Yale's admissions materials?) We would also have to assess the extent to which disclosing some of this information would or would not have interfered with the effective communication of other useful information.

In asking these questions, my point is not to claim that Yale or any other university should have to disclose this information. Instead, my point is simply that designing an efficient disclosure regime often involves subtle costs and tradeoffs—and those tradeoffs do not become any less important just because liability is said to rest on misrepresentation rather than on nondisclosure. True, our moral intuitions may bristle more sharply at words like “misrepresentation” or “fraud” than they do at words like “nondisclosure.” But these intuitions are reliable only under the oversimplified quantized theory of information, or in the simplest cases involving sellers whose claims produce only bad effects and no good ones (“this product cures cancer”). In the kind of real-world cases that are likely to be disputed, a closer attention to the costs and benefits of each solution is inescapable.

3. Misrepresentation by Hewlett-Packard?

Of course, the Yale case is entirely hypothetical, in the sense that no misrepresentation claim was ever filed in court. There are, however, any number of real misrepresentation cases that raise similar issues.

For example, in one case, the Hewlett-Packard Company advertised printers that were sold with free ink cartridges included. However, the included cartridges contained only half as much ink as a normal cartridge, so that customers had to buy replacement

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cartridges (also sold by Hewlett-Packard) sooner than they might otherwise have expected.¹⁴³ The actual language of Hewlett-Packard's promotional materials described its printers as including an "economy" cartridge, so the company argued that their use of "economy" as a modifier should have alerted buyers to the fact that the cartridges did not contain the normal amount of ink. The trial court agreed with Hewlett-Packard, and granted summary judgment dismissing the buyers' claims. But the appellate court reinstated the claims, ruling that there was a triable issue of fact as to just how most buyers would interpret a phrase like "economy cartridge."¹⁴⁴

One way to address that issue would be to conduct empirical tests, surveying representative panels of consumers to see how they interpreted Hewlett-Packard's promotional materials. In practice, though, such tests would probably show that some consumers did assume that "economy cartridges" contained less ink, while other consumers made no such assumption. Faced with such evidence, the court would then have to decide how many (or how few) consumers would have to draw the false interpretation in order to make the phrase "economy cartridge" count as a misrepresentation of the actual cartridges' contents. As noted earlier, this sort of evidence is often used by the FTC, or by federal courts deciding cases under the Lanham Act.¹⁴⁵

In deciding that issue, though, the court should also consider whether it really would have been better for Hewlett-Packard to have said something different. In this case, the only way to cure the misrepresentation by saying *less* would have been (1) by eliminating the word "economy" as a modifier, which probably would only have made matters worse; or (2) by not telling consumers there was any sort of cartridge included with the printer, which would have deprived consumers of useful information. Thus, this is more likely to be a case where Hewlett-Packard, if they should have done anything differently at all, should have said *more* rather than *less*, by

¹⁴³ Johnson v. Hewlett Packard Co., No. CX-01-1641, 2002 WL 1050426, at *1 (Minn. Ct. App. May 22, 2002). The plaintiffs alleged common-law fraud and negligent misrepresentation, as well as a violation of Minnesota's state consumer protection statutes. *Id.*

¹⁴⁴ *Id.* at *5-6.

¹⁴⁵ See *supra* Section III.A.

telling consumers more explicitly about the limited amount of ink contained in the included cartridges. Once the case is seen in this light, the ensuing questions are then indistinguishable from those raised by any affirmative disclosure requirement. That is, precisely what information should have been disclosed? And in what format? Would disclosing information in that format have interfered with the communication of any other useful information? And so on.

4. Misrepresentation by Sellers of Apartment Buildings?

As a final example, consider the many cases in which the buyers of apartment buildings or other property learn that their new purchase is not zoned for multi-family occupancy, or that it violates some other law that prevents it from being legally used for the purpose for which it was purchased. Sometimes these cases are litigated under the doctrine of mutual or unilateral mistake;¹⁴⁶ and sometimes, if the seller knew about the zoning violation, they are litigated on a pure nondisclosure theory.¹⁴⁷ In other cases, though, depending on what the seller actually said, buyers have obtained relief on a misrepresentation theory, either under the common law or under a state consumer protection statute.¹⁴⁸

For example, in one case the court began its analysis by assuming that if the seller had not said anything false, it could not be held liable simply for failing to disclose the fact that local zoning laws did not allow multi-family dwellings in that district.¹⁴⁹ However, in this case the seller had not simply remained silent, but had advertised the building as “Income gross \$9,600 yr. in lg. single house, converted to 8 lovely, completely furn. (includ. TV and china) apts. 8

¹⁴⁶ See, e.g., *Lenawee County Bd. of Health v. Messerly*, 331 N.W.2d 203, 205 (Mich. 1982) (refusing to grant relief despite a mutual misapprehension of fact); *Gartner v. Eikill*, 319 N.W.2d 397, 400 (Minn. 1982) (granting rescission on grounds of mutual mistake).

¹⁴⁷ See, e.g., *Cheshire v. Lockwood*, No. 122135, 2005 WL 1634776, at *8 (Conn. Super. Ct. June 9, 2005) (denying relief).

¹⁴⁸ See, e.g., *Golt v. Phillips*, 517 A.2d 328, 332–34 (Md. 1986) (awarding damages under the state’s consumer protection act).

¹⁴⁹ *Kannavos v. Annino*, 247 N.E.2d 708, 711 (Mass. 1969). The court also noted that Massachusetts law on nondisclosure, at least at that time, may have differed from the law of other jurisdictions. *Id.* at 711 n.6.

baths, ideal for couple to live free with excellent income.”¹⁵⁰ Because the advertisement explicitly referred to the building as a multi-family dwelling that could be used as an investment property, the court treated the ad as implicitly representing that the building could *legally* be used for that purpose, thus misrepresenting the building’s actual legal status.¹⁵¹

Here, the court may have been on solid ground in concluding (even without empirical evidence) that most buyers would interpret such an ad as offering a *legal* apartment building—though even that might depend on local custom, including such things as how often noncomplying buildings were nevertheless bought and sold. Still, my main point is that even if we interpret this statement as implicitly false, questions still remain about what the seller ought to have said instead. For example, should the seller have removed all reference to the fact that the building could be occupied by more than one family? Such a correction would either have made the ad very confusing to its likely audience (that is, buyers interested in purchasing *multi-family* investment properties); or it would have had no effect at all, because anyone who looked at the building could easily see that it was being used as a multi-family residence. Indeed, the court suggested that the very appearance of the building could itself be interpreted as a misrepresentation—that is, as an implied statement that the building could legally be used for the purpose for which it was designed¹⁵²—so it is doubtful that the alternative of saying *less* would have improved matters at all.

Instead, this case too seems like one in which the proper solution (if any) would have been for the seller to say *more*, by affirmatively disclosing something about the zoning violation.¹⁵³ To be sure, similar questions would then have to be asked about what, precisely,

¹⁵⁰ Id. at 709.

¹⁵¹ Id. at 712. For a similar holding, see also *Simonsen v. BTH Props.*, 410 N.W.2d 458, 461–62 (Minn. Ct. App. 1987).

¹⁵² See *Kannavos*, 247 N.E.2d at 712.

¹⁵³ I set aside here—though the court did not—questions about whether this sort of information was best acquired by the seller or by the buyer, and who could have researched the relevant zoning laws. In this case, the seller already knew that the building did not comply with the zoning laws, and the buyer was a Greek immigrant who was self-employed as a hairdresser. Id. at 709; cf. *Saliterman v. Burdick*, No. CX-99-1427, 2000 WL 272048, at *3 (Minn. Ct. App. Mar. 14, 2000) (finding no actionable misrepresentation of legality in a case where the seller was *not* aware of the zoning violation).

the seller should have disclosed, and at what point in the transaction, and with what degree of prominence. Clearly, though, these issues play out no differently in this “misrepresentation” case than they would in any case where the gravamen of the complaint was a pure failure to disclose.

IV. MISREPRESENTATION AND NONDISCLOSURE AS ENTERPRISE LIABILITY

The preceding two Parts of the Article assumed that the goal of any legal regime was to alter (and improve) the *information* that parties provide. As a consequence, those Sections argued that liability for misrepresentation or nondisclosure is appropriate only if there was something the party could have said differently that would have improved matters for her customers. Otherwise, if she could not have said anything else that would have been an improvement on what she actually said, it is counterproductive to hold her liable *if the purpose of liability is to change the information she conveys*.

In some cases, however, the purpose of liability may instead be to make one party *assume the risk* of some adverse consequence, without trying to change the information she conveys. For example, if there is some risk that a product might be defective, or that a franchise might not be awarded, the law could hold sellers or franchisors strictly liable for that outcome without regard to the information they conveyed. As a result, buyers and franchisees would then be insured against an adverse outcome. At the same time, sellers and franchisors would have to adjust their prices to cover their expected liability costs, so the risks associated with any particular seller or franchisor would to some extent be reflected in her price.

In tort law, this alternative regime is often referred to as “absolute liability” or “enterprise liability,” where it has been the subject of extensive debate.¹⁵⁴ While that debate is far too extensive to can-

¹⁵⁴ For a history of this approach to liability, see George L. Priest, *The Invention of Enterprise Liability: A Critical History of the Intellectual Foundations of Modern Tort Law*, 14 J. Legal Stud. 461 (1985). For a recent summary of the arguments pro and con, see, for example, Croley & Hanson, *supra* note 32; James A. Henderson, Jr. & Jeffrey J. Rachlinski, *Product-Related Risk and Cognitive Biases: The Shortcomings of Enterprise Liability*, 6 Roger Williams U. L. Rev. 213 (2000); Jon. D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: A Response to Market Manipulation*, 6 Roger

was here (much less to resolve), I note that there can be informational advantages to reflecting a seller's riskiness in her price. After all, price is much easier to communicate than is detailed information about product performance or about the likelihood that a franchise will be granted. Also, price has the convenient property of being expressible as a continuous index, so it can reflect any *changes* or *differences* in firm-specific risk levels, not just the overall average risk.¹⁵⁵

On the other hand, there are also drawbacks with price as an index that may make enterprise liability less than ideal—hence the debate noted earlier. For example, a seller's price will not accurately reflect the true risks if the likely damages vary across different customers, yet the seller cannot adjust for those differences by charging different prices to different customers.¹⁵⁶ A seller's price also will not reflect risks accurately if the damages she must pay are not measured accurately, either because some losses are hard to translate into a monetary value,¹⁵⁷ or because smaller damage awards are desirable for reasons having to do with consumers' own incentives. Another difficulty stems from the fact that many losses are caused by the interaction of several products, and a system in which each plaintiff recovers his losses only once offers no way to make the manufacturer of *each* contributing product internalize *all* of the relevant costs.¹⁵⁸

Significantly, contract law has its own forms of “enterprise liability,” though it is not often labeled as such, so the point may be less familiar. Still, implied warranties in contract law generally reflect a judgment that the seller should assume responsibility for *all* defects in her product (or all defects of a certain kind), thus reflecting the

Williams U. L. Rev. 259 (2000). Latin, *supra* note 1, at 1292–94, briefly considers enterprise liability as a solution when disclosures are (in his view) unlikely to be effective, but he does not discuss the issue at any length.

¹⁵⁵ See the discussion of absolute versus relative information *supra* in Section II.C.

¹⁵⁶ See, e.g., Gwyn D. Quillen, Note, Contract Damages and Cross-Subsidization, 61 S. Cal. L. Rev. 1125 (1988).

¹⁵⁷ Robert Cooter, Prices and Sanctions, 84 Colum. L. Rev. 1523, 1542–43 (1984) emphasizes this difficulty.

¹⁵⁸ See, e.g., Hanson & Kysar, *supra* note 154, at 316–23 (discussing this as a “causation” problem).

resulting liability costs in her price.¹⁵⁹ In addition, sellers are usually held strictly liable for whatever they have explicitly promised to perform,¹⁶⁰ so contract law's enforcement of explicit promises might also be said to adopt "enterprise liability" for any risks that involve a breach. As a result, courts deciding contracts cases often implicitly choose between enterprise liability and some other regime in the course of deciding such issues as whether to imply a warranty, or how to interpret the seller's promise, or (for that matter) whether to find an enforceable contract at all.

I mention these doctrines here because misrepresentation or nondisclosure provide another, less-appreciated way in which courts that are so inclined can shift to an implicit regime of enterprise liability for problems not already covered by a warranty or by an express promise. As noted earlier, courts often have flexibility in deciding whether to interpret a given statement as a misrepresentation, or in deciding whether a seller's warnings or disclosures were adequate. If courts set those standards extremely high—so high that, as a practical matter, sellers will not find it cost-effective to comply—then sellers will always be liable, and the regime will effectively be one of enterprise liability. To be sure, disclosure standards set at such a high level might not be appropriate in a regime that aimed to alter or improve the *information* that sellers disclosed. But high disclosure standards might nevertheless be attractive to any court that believed, perhaps only subconsciously, that it was more appropriate to hold sellers absolutely liable for certain kinds of risks.

Indeed, Professor Kenneth Abraham has argued that this is precisely how courts (in some cases) have interpreted the "reasonable expectations" doctrine that is often applied to insurance contracts.¹⁶¹ This doctrine allows courts to set aside the terms of boilerplate contracts that no customers ever read, if and to the extent

¹⁵⁹ For a discussion of implied warranties that emphasizes their similarity to products liability, see George L. Priest, *A Theory of the Consumer Product Warranty*, 90 *Yale L.J.* 1297 (1981).

¹⁶⁰ The qualifier "usually" excludes cases where performance is prevented by some factor that gives the seller an excuse, under doctrines such as impracticability or mistake. It also excludes cases, such as many contracts for professional services, where the seller does not actually promise particular results but merely promises to use something like "reasonable professional care."

¹⁶¹ Abraham, *supra* note 27.

that those terms conflict with the “reasonable expectations” of policyholders. In Abraham’s view, some of these cases are ones in which the insurance company affirmatively misrepresented the terms of the policy, in ways that could have and should have been corrected by the company.¹⁶² In these cases, then, courts are trying to correct the insurance company’s *informational* behavior.

In other cases, though, Abraham sees courts as deciding that certain kinds of risks ought to be covered by insurance companies, and are imposing liability accordingly, without regard to anything the insurance company could or should have said.¹⁶³ To be sure, in both sets of cases the courts might describe the insurance company as having misled consumers, or as having failed to disclose the hidden terms and conditions of its policy. But only in the first set of cases do courts want to correct the *informational* behavior of the insurance companies, by actually inducing insurance companies to say less or to say more. In the second set of cases, by contrast, liability can be justified only if the insurance company ought to bear this risk, independently of any changes it might make in its informational behavior.¹⁶⁴

In short, high standards for misrepresentation or nondisclosure can certainly be used to shift certain risks to defendants, in cases where we do not realistically expect the defendant’s informational behavior to change. Indeed, the willingness of some commentators to find a misrepresentation in cases like *Hoffman v. Red Owl* may be another example of this phenomenon. As discussed earlier, it is far from clear whether it would have been better if Red Owl had changed its informational behavior, either by not offering the franchise to Hoffman in the first place, or by disclosing additional information about the actual probability that the franchise would be granted. Viewed purely in terms of potential changes in informational behavior, then, the case for liability is questionable.

¹⁶² Id. at 1155–62; see also Kenneth S. Abraham, A Theory of Insurance Policy Interpretation, 95 Mich. L. Rev. 531, 540–44 (1996) (describing some decisions as implicitly applying a “negligence” standard, by asking whether the insurance company could feasibly have done a better job describing its policy).

¹⁶³ Abraham, supra note 27, at 1162–68 (describing what he labels “mandated coverage” cases).

¹⁶⁴ Id.

It would not, however, be at all implausible to believe that Red Owl is the party who *ought* to bear the risk in question—that is, the risk of whatever contingency it was that led them ultimately to deny Hoffman’s franchise application—for reasons that have nothing to do with any information that Red Owl may have conveyed. Instead, maybe this contingency is so much within Red Owl’s control, and so much a matter of Red Owl’s superior information, that the risk would be better borne by Red Owl under a form of enterprise liability. And if such a result seems initially strange, or somehow foreign to contract law, consider that if Red Owl had been interpreted as actually offering a franchise to Hoffman (using “offer” here as a technical term of contract law), then Red Owl would indeed have been strictly liable for breach of contract if it failed to grant the franchise, so strict or enterprise liability would indeed have been the result.¹⁶⁵ It may be that this instinct—rather than any belief that Red Owl should have changed its *informational* behavior—is what has led many commentators to find a misrepresentation in the *Red Owl* case.¹⁶⁶

Of course, the arguments for and against enterprise liability are complex, and this Article is not the place to enter into those various complexities. Instead, in the following Part I limit my focus to cases in which the law’s aim really is to alter the *informational* behavior of the parties, rather than altering the allocation of risks without altering the information that is exchanged. For those cases, whatever formal legal doctrine they are litigated under, I offer the following proposals for reform.

¹⁶⁵ If Red Owl had legally *offered* Hoffman a franchise, Hoffman’s subsequent reliance would most likely have counted as a legal acceptance of the offer, or at least as enough to otherwise make the offer irrevocable under Restatement (Second) of Contracts § 87(2) (1981). In the actual case, the Wisconsin Supreme Court could not employ that route to liability, for the trial jury had found (in a special verdict) that Red Owl’s statements did not rise to the level of a legal “offer and acceptance” sufficient to create a binding contract. *Hoffman v. Red Owl Stores*, 133 N.W.2d 267, 272 (Wis. 1965). Instead, the trial jury found that Red Owl had merely made a “representation,” which the Wisconsin Supreme Court interpreted as a *promise*—thus leaving generations of law students to puzzle over the difference between the two. *Id.*

¹⁶⁶ See Ayres & Klass, *Insincere Promises*, *supra* note 15, at 148–49; Barnett & Becker, *supra* note 119, at 489–95; Gergen, *supra* note 129, at 34.

V. SOME MODEST REFORMS

If contract law currently required too much disclosure, or if it overly deterred the communication of useful information, the relevant reforms to consider might be similar to those now being considered in products liability. For example, it might be urged that misrepresentation and nondisclosure cases should be removed from the common-law courts entirely and handed over to regulatory agencies.¹⁶⁷ It might also be urged that the damages be reduced in cases of misrepresentation and nondisclosure, perhaps even all the way to prospective relief only. After all, when federal agencies require disclosure via regulations, those regulations spell out exactly what is required prospectively. Even when the FTC prosecutes individual cases of deception or nondisclosure, the normal administrative remedy for a first offense is a prospective cease-and-desist order.¹⁶⁸

Nevertheless, I do not recommend any of these reforms here. For one thing, resource constraints make it unlikely that federal regulatory agencies will ever be able to deal with the vast range of concerns that can arise in common-law misrepresentation or nondisclosure cases. In addition, as I have noted earlier, those doctrines have not yet been used aggressively by courts, so it is entirely possible that the more serious concern is one of underdeterrence rather than overdeterrence.

In particular, there are surely some cases where the behavior in question *ought* to be deterred. These are the cases involving out-and-out frauds: the seller who advertises that her product will cure cancer (when it won't), or the scam artist who collects money for products that he has no intention of delivering. Ayres and Klass are correct to point out the undesirability of such behavior, and the possible appropriateness of punitive damages or criminal sanctions.¹⁶⁹ They are also correct to point out that, at least on some understandings of misrepresentation and nondisclosure doctrine, it is

¹⁶⁷ See *supra* text accompanying note 31.

¹⁶⁸ Note, too, that even ordinary compensatory damages can sometimes lead to overdeterrence, if the standards that trigger liability are uncertain in particular ways. Richard Craswell & John E. Calfee, *Deterrence and Uncertain Legal Standards*, 2 *J.L. Econ. & Org.* 279, 299 (1986).

¹⁶⁹ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 80–81, 170.

probably too hard (not too easy) to make out liability in these cases.¹⁷⁰

Instead, what I suggest is a series of more modest proposals, designed to sharpen the courts' focus on the appropriate policy questions. While these recommendations may seem strange or unfamiliar to those versed only in contracts scholarship, torts and regulatory scholars will not be as surprised.

1. In a misrepresentation or nondisclosure case, the plaintiff must specify some alternative(s) to whatever the defendant actually said.¹⁷¹

In misrepresentation cases, this would require the party complaining of the misrepresentation to allege either that the other party should have said less, by eliminating something she said; or that she should have said more, by adding something in addition to whatever she actually said. In the latter case, the complaining party should identify precisely what the other party should have said—that is, not just “the defendant should have disclosed the probability of performance,” but rather “the defendant should have disclosed this exact information about the probability of performance, in this exact format, and at this exact point in the negotiations.” In nondisclosure cases, of course, the complaining party must already identify (at some level of abstraction) just what it was that the defendant failed to disclose. Still, I would be even more specific and require the plaintiff to identify the desired disclosure more precisely.

This reform would bring misrepresentation and nondisclosure closer to design defect cases in torts, in which the plaintiff generally must identify some alternative to the manufacturer's design.¹⁷² As in

¹⁷⁰ For example, some courts have held that statements or predictions about *future* events cannot support an action for fraud, and Ayres and Klass convincingly argue that this rule should be abandoned. *Id.* at 59–60.

¹⁷¹ For convenience, I will speak of the complaining party as the plaintiff and the other party as the defendant. In actual practice, those roles are often reversed, as when the party complaining of the misrepresentation or nondisclosure is doing so as a defense to the other party's attempt to enforce the resulting contract.

¹⁷² Generally, though not always: For an exception, see *Potter v. Chi. Pneumatic Tool Co.*, 694 A.2d 1319, 1331 (Conn. 1997). On the role of identified alternatives in negligence cases more generally, see Mark F. Grady, *Untaken Precautions*, 18 *J. Legal Stud.* 139 (1989).

those cases, the plaintiff would not have to limit himself to a single alternative: He could also argue different theories in the alternative (for example, “the defendant either should have said nothing at all about her product’s reliability; or she should have disclosed, in her advertising, the number of complaints and/or warranty claims she received over the last three years”). But it should not be sufficient simply to allege that “the defendant’s advertisement implicitly represented her product as being more reliable than it was,” without identifying whatever it is that the defendant should have said instead. Once it is recognized that single bits of communication can convey more than one message, an allegation that a single false message has been conveyed can no longer be sufficient for liability.

2. Once one or more alternatives have been identified, either party should be allowed to dispute the costs or benefits of those alternatives.

The principal advantage of requiring specific alternatives to be identified is that it will then be possible for courts to better consider whether any of those alternatives would have been superior to whatever the defendant actually said. If the alternative would have involved saying less, then it should be open for the plaintiff to argue that very little would be lost if the defendant had not made a certain claim, just as it should also be open for the defendant to argue that a good deal of useful information would have been lost. (I take no position here on which party should bear the burden of proof.) Similarly, if the preferred alternative would have required the defendant to say something more, the defendant should be allowed to argue that the additional information would have diluted the impact of other, more valuable messages, while the plaintiff should be allowed to show that the additional information could have been communicated cheaply and easily.

Notice, by the way, that in some cases the evaluation of costs and benefits will rest on issues very similar to those considered by Ayres and Klass. In particular, if the claim is that the defendant misrepresented the probability that she would perform, in some cases the plaintiff will argue (as a superior alternative) that the defendant should have said less, because she should not have made the promise in the first place. If the defendant is a legitimate business with a reasonably high probability of performing her contracts,

this argument by the plaintiff will usually fail. But if the defendant is a complete con artist, making promises that she has never performed, the probability of performance will be so low that little or nothing will be lost if she stops making those promises in the future.

To be sure, it may seem difficult (or even presumptuous) for a court to decide, with respect to any particular party, that the chance of her actually delivering on her promise is so low that she shouldn't be allowed to stay in business. Nevertheless, this is implicitly what courts *have* to decide, if they are going to decide that the bare fact of a party's promise should be treated as an actionable misrepresentation. That is, the cases in which there is no feasible alternative that involves disclosing *additional* information are those cases in which the only alternative to making a deceptive promise is to make no promise at all. If courts (in effect) require such a defendant to stop making any promise at all, they will in fact be putting that defendant out of business—as indeed they probably *ought* to, if the defendant is truly a con artist with little or no chance of performing. My recommendation is designed to make sure that courts are aware of that effect, and that they employ it only when it is desirable.

3. In evaluating the relevant costs and benefits, either party should be allowed to introduce empirical evidence as to how similar contracting parties would be likely to respond to the identified alternatives.

For example, if the plaintiff claims that his preferred alternative is for the defendant to stop using a particular tag line on its advertisement, it should be open to the defendant to show that removing that tag line would have had little or no effect on the number of customers who were deceived by the advertisement. Similarly, if the defendant objects that adding an additional disclosure would severely interfere with the communication of some other piece of truthful information, it should be open to the plaintiff to introduce tests in which a set of revised promotional materials (which included the additional disclosure) were shown to be just as effective in communicating the other information.

As noted in Section II.B, empirical studies of this sort are becoming quite common in advertising cases litigated under the FTC

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Act or the Lanham Act. There is no reason to require such evidence in *every* case, for some cases (“this product cures cancer”) will be so easy as to make it unnecessary. Even in harder cases, it will often be unnecessary to *require* the use of empirical evidence because one or the other of the parties (or both) is likely to find it in their own self-interest to introduce that evidence. Thus, the only reform that is needed is to clarify that the parties are *permitted* to introduce such evidence. Once introduced, the evidence should be treated with whatever seriousness it deserves.

Indeed, the use of empirical evidence may have an effect that goes well beyond improved decisionmaking in the single case to which any evidence pertains. In the case of the federal consumer protection statutes, greater use of empirical evidence has greatly eased the courts’ and agencies’ recognition that individual speech acts can convey many different assertions.¹⁷³ Since this is precisely what the empirical tests nearly always show, judicial recognition of this fact has been almost unavoidable in FTC and Lanham Act cases. At the same time, though, the repeated use of empirical evidence has also taught courts and agencies that it is not always possible to eliminate *every* false implication (at least, not without paying an unacceptable cost), and that some false implications are more easily eliminated than others. As a result, courts and agencies applying these statutes—compared, for instance, to state courts applying products liability law—seem much less quick to conclude that the defendant should have disclosed just one more fact, or that the defendant just shouldn’t have used that particular word or phrase.

4. In evaluating the relevant costs and benefits, the materiality of all information should be carefully considered.

Nominally, this merely restates existing law, for only material misrepresentations are actionable, and only material information is supposed to be disclosed. What is not always appreciated, however, is that materiality is a matter of degree, rather than an either-or binary characteristic. For example, if a lack of information or a false claim would lead consumers into some very serious error, that information is highly material, and defendants should be ordered to

¹⁷³ See *supra* Section II.A.

take more stringent steps to correct the problem. Similarly, if adding additional disclosures would significantly interfere with some other highly material point, courts should take that effect extremely seriously as well, and should therefore be slow to require those disclosures. If, on the other hand, a false claim or a lack of information leads (at worst) to a relatively trivial error, neither of these concerns would be as telling.

A closely related point is that misrepresentation or nondisclosure of a party's subjective intentions should almost never *by itself* suffice for liability. As Ayres and Klass note, subjective intentions are usually material only for what they tell us about the actual probability that a party will perform.¹⁷⁴ This means that evidence about a party's intentions can certainly be relevant in assessing the probability of her performance, as Ayres and Klass also discuss. But on my view, a party's intentions should be relevant *only* for this purpose: as evidence bearing on whether the probability of performance (or any other material fact) has been misrepresented or not disclosed. In contrast to Ayres and Klass, I would not allow a claim that the other party's intentions have themselves been misrepresented or not disclosed.

The danger here is not merely that intentions themselves are not always material, and thus might not be worth worrying about (if, for example, the probability of performance was high for other reasons). In addition, the more fundamental problem is that treating "intentions" as a relevant fact makes it too easy to overlook the relevant tradeoffs. If we ask what the other party knew or was told about the probability of performance, this naturally suggests an inquiry that is continuous or a matter of degree (How high was the actual probability of performance? And how high did the other party think it was?). By contrast, inquiries into intentions too easily slide into a binary inquiry: Either the defendant intended to perform, or she didn't. Even when her intentions were conditional, or were otherwise more complex, the usual legal tendency—apparent even in Ayres and Klass's analysis—is to treat intention as a binary, yes-or-no variable. This tendency too easily lends itself to categorical conclusions, in which any balancing of costs and benefits is sup-

¹⁷⁴ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 35; see also *supra* text accompanying note 139.

pressed, or at best is done covertly. That is, if we decide the defendant “did not intend to perform,” it seems to follow that she must have misrepresented her intentions *regardless of the costs and benefits associated with anything else she could have said*. Conversely, if we decide that the defendant “did intend to perform,” it seems to follow that she must not have misrepresented her intent, *again regardless of the costs and benefits of any alternatives*.

To be sure, if courts or agencies are consciously evaluating the costs and benefits (see my second recommendation), this danger may not be severe. But if courts or agencies are consciously evaluating the costs and benefits, then the fact that customers may have been misinformed about a party’s intentions will by itself carry very little weight, *except* insofar as it leads us to conclude that the party has also been misinformed about the actual probability of performance. In other words, as long as the probability of performance is what is material to customers, that is the variable that will normally carry most of the weight, both in assessing potential costs and in assessing potential benefits. Parties’ intentions, by contrast, will be relevant (in a cost-benefit analysis) *only* for what they tell us about the costs and benefits of the more material variables.

5. If punitive or criminal penalties are employed, they should be used only when the balance of costs and benefits makes it obvious that the defendant should have behaved otherwise than she did.

The question of whether punitive remedies should be employed at all is a difficult one that is well beyond the scope of this Article. Indeed, this question has little uniquely to do with misrepresentation and nondisclosure, so I will not attempt to resolve it here. On the one hand, punitive sanctions can sometimes make up for what would otherwise be inadequate deterrence; but they can also lead to a “chilling effect” (that is, excessive deterrence), thus causing defendants to change their informational behavior in undesirable ways.¹⁷⁵

¹⁷⁵ For discussions of the economic issues raised by punitive sanctions generally, see, for example, A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 *Harv. L. Rev.* 869 (1998); Richard Craswell, *Deterrence and Damages: The Multiplier Principle and Its Alternatives*, 97 *Mich. L. Rev.* 2185 (1999). Some noneconomic considerations are discussed in Bruce Chapman & Michael Trebilcock,

As a matter of positive law, however, punitive damages are sometimes available for misrepresentation or fraud, and in some cases even criminal sanctions may be available.¹⁷⁶ I therefore follow Ayres and Klass in arguing that those sanctions should be reserved for conduct that is *clearly* inefficient. As Ayres and Klass put it, if the defendant's behavior is reckless (or worse), "[t]he very definition of recklessness requires that there be a large gap between the cost of the risk and the cost of avoidance, which means that errors at the margin don't threaten innocent promisors."¹⁷⁷

The only point I add is that this line is not easy to draw unless the courts consciously consider the costs and benefits of the defendant's possible alternatives, in the way that I have recommended here. That is, if courts consciously focus on whatever it is that the defendant should have done instead (recommendation #1), and if they consciously evaluate the costs and benefits of the possible alternatives (recommendations #2 and #3), it will then be relatively easy to tell when it is clear that the defendant should have behaved differently, and when it is a closer call.

Under Ayres and Klass's analysis, by contrast, the relevant costs and benefits will not have to be consciously considered by the court. Again, their discussion of *Red Owl* can serve as an example. In that case, Ayres and Klass concluded that Red Owl was likely guilty of at least reckless misrepresentation, both of their intentions and of the probability of performance, on the ground that the probability of performance was believed (by Ayres and Klass) to be very low.¹⁷⁸ Indeed, once Ayres and Klass concluded that Red Owl's intention was properly classified as an "intent not to perform," it followed (for them) that Red Owl should be held liable without re-

Punitive Damages: Divergence in Search of a Rationale, 40 Ala. L. Rev. 741 (1989); and Marc Galanter & David Luban, Poetic Justice: Punitive Damages and Legal Pluralism, 42 Am. U. L. Rev. 1393 (1993).

¹⁷⁶ Ayres & Klass, *Insincere Promises*, supra note 15, at 170–86.

¹⁷⁷ *Id.* at 76 (footnote omitted). In economic terms, this is a regime in which the probability of escaping punishment is not constant, but rather is likely to vary with the egregiousness of the defendant's behavior: Outright lies and other statements that clearly fail any cost-benefit test are more likely to be punished than mere borderline cases. In such a regime, overdeterrence is likely to result if punitive sanctions are applied to conduct that only marginally fails a cost-benefit test. Craswell & Calfee, supra note 168, at 292–95; Craswell, supra note 175, at 2191–94.

¹⁷⁸ Ayres & Klass, *Insincere Promises*, supra note 15, at 148–49; see also supra Section III.B.

gard to the costs or benefits of anything else that Red Owl should have said—and, indeed, without even identifying what it was that Red Owl should have said differently (hence my recommendation #1). If liability can rest on this sort of analysis, it will be hard for courts even to decide whether Red Owl's or any other defendant's behavior involved "a large gap between the cost of the risk and the cost of avoidance."¹⁷⁹ As a consequence, it will also be hard for courts to tell if punitive damages could safely be imposed without risking overdeterrence.

CONCLUSION

It might be objected that the reforms proposed here are simply too difficult for courts to manage. Empirical evidence and the careful balancing of costs and benefits, it might be said, may be well and good for regulatory agencies with staffs of experts. But courts are simply not capable of this sort of fine-tuning (the argument would run), so they are better off deciding cases using simpler principles.

Of course, a partial answer to this objection might be to point to federal court decisions under the Lanham Act, where courts routinely consider empirical evidence and (if only implicitly) balance the relevant costs and benefits.¹⁸⁰ A more important answer, however, is that there are no "simpler principles" that are at all attractive as alternatives. The fact is, the transmission of information is a complicated business, and if courts are going to regulate that business—as I believe they should—then they ought to be willing to make some complicated decisions.

Perhaps an analogy will help. In cases involving product design, or in the regulation of technical issues like automobile safety, legal scholars are accustomed to the fact that many issues will have to be addressed by technical or scientific experts. If courts must decide, for instance, whether automobile bumpers should be made of heavier material, or whether an automobile's gas tank should have been placed at a different location, nobody expects that a judge or a law professor should be able to make such decisions on the basis of "simple principles." Instead, in these cases we regularly admit the

¹⁷⁹ Ayres & Klass, *Insincere Promises*, *supra* note 15, at 76.

¹⁸⁰ See generally *supra* Section III.A.

testimony of experts—and, where relevant, we admit empirical tests and studies—to assess the tradeoffs involved.

Where information is concerned, however, the common law has followed a different tradition. Information is something that everyone deals with, so doctrines such as misrepresentation and nondisclosure are not usually thought to require any special expertise. In other words, common-law courts (and common-law scholars) have not usually recognized any equivalent to an “information engineer,” who might study empirically the tradeoffs involved in an advertisement or a sales presentation.

My aim in this Article has been to show why this view of information is outmoded. Instead, designing information is at least as complex as designing an automobile’s bumper, and it ought to be recognized as such. This recognition has come already in many areas of regulatory law, and it is beginning to come to tort law in the “duty to warn” cases. Perhaps one day, that recognition will come even to the common law of contracts.