

The Law, Ethics and Economics of Information

Anthony Duggan, Michael Bryan and Frances Hanks, Contractual Non-Disclosure: An Applied Study in Modern Contract Theory, Longman Australia, Melbourne, 1994

Reviewed by Ian McEwin

TO what extent should the law require contractual disclosure? Where should the line be drawn between acceptable and non-acceptable commercial behaviour? As the authors of *Contractual Non-Disclosure* show, this is a question that has intrigued moralists and jurists since Cicero considered whether a grain-merchant arriving in famine-stricken Rhodes should tell the Rhodians that more grain ships were on the way. Moralists tend to argue for disclosure. For example, Verplank believes that contacts should be judged by ethical 'good faith' standards that impose legal obligations to disclose. Yet the common law, traditionally, does not usually require disclosure because, at least in part, 'the kind of selfless behaviour demanded by the broad ethical position is inconsistent with the notion of a competitive economy' (p. 11).

But there are exceptions to the general rule that silence is permissible. The three Melbourne-based authors of this study (Anthony Duggan is Professor of Law at Monash University, Michael Bryan and Frances Hanks are Senior Lecturers in Law at the University of Melbourne) draw on 27 hypothetical case studies and identify five categories where non-disclosure can amount to fraud. These are: where there is a mistake; where there is a misrepresentation; where one party suffers from a disability that affects contractual capacity; where withholding information exploits trust; and in insurance contracts which, unlike other kinds of contract, imply 'utmost good faith'. The authors show that the legal doctrines in these areas are not settled; rather, they are 'affected by problems of indeterminacy. For example, in relation to the doctrine of mistake there are important questions, still unresolved in the case law, relating to the kinds of mistake that qualify for judicial intervention' (p. 13).

The book adopts a positivist methodology to determine which of three competing theories of contract law — 'autonomy', 'fairness' and 'economic' — best explains the non-disclosure cases. Autonomy theories focus on an individual right to self-determination and 'emphasise security of transactions (on the basis that, if an individual can get out of a contract too easily, contracts will be harder to enter into in the future)' (p. 85). Here an individual could not be bound by contract unless the promise had been freely given. But can courts determine actual will? What if parties to a contract have different understandings? Should a court decide, objectively, what the parties had agreed? As the authors point out, an objectivist approach will result in fewer contracts being put aside for non-disclosure than will a subjectivist approach. The former looks to imputed knowledge; the latter to actual knowledge. Fairness theories, meanwhile, stress equality or the sharing of available

information. "The duty to disclose is said to be prompted by a concern that parties treat each other in a way that is consistent with the "bonds of community" (Cicero), or a concern with the fairness of the outcome (Aquinas's and Pufendorf's just price), or a concern that the parties bargain from a position of equality (Pothier)' (p. 123).

The authors conclude, however, that the economic approach is superior to autonomy and fairness theories. It concentrates on 'the need to preserve incentives for the discovery and exploitation of information (profit-making from superior information should be permissible)' (p. 14). For example, where one party makes a mistake about the price of a transaction (a catalogue gives the wrong price of a painting, say) there is simply a redistribution to the non-mistaken party, which is of no concern from an efficiency perspective. But the disclosure rule should attempt to reduce future mistakes. This can be done by requiring the least-cost information gatherer to disclose. If the mistake is made by the least-cost information gatherer, then imposing a duty to disclose on the other party will reduce the incentive of the mistaken party to check the information. On the other hand, if the low-cost information gatherer knows that the other party has made a mistake, it is efficient to require disclosure: otherwise, the high-cost gatherer will incur that cost unnecessarily. Thus, 'these considerations provide an explanation for why disclosure is required of pricing errors, but only where B [the knowledgeable party] knows or ought to know of A's mistake. Where this condition is not satisfied, the contract should be allowed to stand' (p. 155).

This is an outstanding book and it deserves to be widely read. It will appeal not only to those with an interest in contract law but also to those who have an interest in the disclosure of information in general, such as statutory requirements to disclose information in prospectuses, as well as labelling and consumer protection laws. It may be that judges are better at understanding the incentives to create and use information than legislators are. As such, the book may be an aid to statutory disclosure provisions.

The authors make good their claim that 'this book is as much about the inevitability of applied jurisprudence, even in an intensely practical world' (p. 15). By reading it, economists will gain an understanding of ethical concerns relating to contract and information disclosure in general and their relationship to efficiency. As well, lawyers can learn how some simple yet powerful economic principles can provide insights into difficult legal problems by stressing the importance of the relative costs of legal rules and the role of incentives in influencing future behaviour.

The book is clearly written and summarises complex ideas such that they can be easily understood by the intelligent layman.

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