

NYU Law and Economics Workshop Participants,

My Faculty Workshop presentation on December 5 will focus on two chapters from a book manuscript (with Carl Schneider) titled

**MORE THAN YOU WANTED TO KNOW:
THE FAILURE OF MANDATED DISCLOSURE**

The book explores the spectacular prevalence, and failure, of what it claims to be the single most common technique for protecting personal autonomy in modern society: mandated disclosure.

The early chapters of the book, which are not circulated now, describe the prevalence of mandated disclosure, survey the large body of empirical literature documenting the frequent failure of the mandated disclosure, and explain why disclosures fails. In those parts, the main novelty is in lumping together and unifying insights and lessons from scattered fields in which mandated disclosures proliferate: consumer financial protection, products liability and product regulation, health law, privacy, insurance regulation, contract law, Miranda warnings, human subject research regulation, real estate transactions, and much more.

For the Workshop, I am circulating two chapters.

Chapter 6 (“The Dynamics of Disclosure”) addresses a paradox: if disclosures so routinely fail, why do lawmakers so often use them to solve new problems?

Chapter 8 (“At Worst, Harmless?”) addresses the “harmlessness hypothesis”—the common belief that mandated disclosure, even if ineffective, does no harm. The chapter explores the unintended harms of mandated disclosure.

I look forward to discussing your reactions.

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Chapter 6

The Dynamics of Disclosure

I would rather disclose than be regulated.

Robert F. Elliott, President
Household Finance Company

We have now identified a regulatory technique – mandated disclosure – that may be the most relied on but least successful one in American law. We have already described two ways in which it is relied on. First, *many* varying kinds of social problems are regulated through mandated disclosure. Lawmakers of all kinds – legislatures (national, state, and local), administrative agencies, and courts – mandate disclosures. Second, once disclosures are mandated, lawmakers expand the scope of those disclosures almost irresistibly.

But if mandated disclosure is so routinely unsuccessful, why do so many kinds of lawmakers so routinely use it to solve new problems? Why do they use this one-size-fits-all device to address such a vast and varied range of social problems? And why do lawmakers repeatedly expand disclosure mandates once they have initially been instituted?

To use an evolutionary metaphor, we have a puzzling species. It is a species—a regulatory technique—that is by standard evolutionary measures wondrously successful: Its numbers have grown prolifically, and it occupies all kinds of environments. Yet the members of the species rarely achieve the purpose for which the species exists. How can we explain a world in which it is the *unfit* that seem to survive? In this metaphorical world, survival is determined by lawmakers, who alone can create and annul regulation. So, why do lawmakers not only keep mandating disclosures in new areas but persistently expand mandates they have already issued? Why is this species so politically successful while at the same time so functionally inept?

In this chapter we examine the reasons for mandated disclosure’s astonishing political resilience. Our purpose here is to describe, not to judge. We want to identify features common to various mandated disclosures, which lure lawmakers to utilize this device. We argue that disclosure mandates are driven by a dynamic that powerfully shapes their creation and perpetuation and that grows out of several forces. Crucial among these forces is the intuitive plausibility of mandated disclosure: It seems obvious that people’s decisions will be improved by more information. That intuitive plausibility is intensified—and, we argue, distorted—by the way “trouble stories” and anecdotes frame the problem presented to the lawmaker through the 20/20 vision of hindsight. In these regulatory dynamics, mandated disclosure is largely non-falsifiable. Failures, if

recognized, are attributed to misguided implementation and not to the regulatory method itself.

Also crucial among the forces that perpetuate disclosures is the intuitive notion—if not the illusion—that mandated disclosure is all upside and no downside. The direct costs of disclosure are rarely borne by the government, while alternative means of regulation can be quite expensive. If there are any indirect costs to disclosures (and in Chapter 10 we will identify some such troubling costs) they are often obscure to lawmakers, or discounted by delay and uncertainty.

Finally, mandated disclosure (unlike most regulatory alternatives) is almost always the politically feasible way for law-makers to respond to pressure to act, not least because it is consistent with the entire spectrum of political opinion. Disclosure laws are rarely opposed, because they vindicate almost every value and agenda in the political spectrum. These dynamics help explain why disclosures are mandated even where they are inappropriate and why even appropriate mandates tend to expand until they become ineffective.

A. THE AXIOMATIC EFFECTIVENESS OF MANDATED DISCLOSURE

The case for mandated disclosure has long seemed so obvious that it is hard to see how it could be wrong. It has seemed so obvious that its usefulness seems axiomatic. Mandated disclosure is a regulatory way of helping people toward good decisions. In particular, it attempts to protect the weaker party making decisions in the context of interactions with a stronger party. Typically but not exclusively an individual is deciding whether to buy a product or service where the individual knows less about the choice than the provider. In a modern society, such decisions are ubiquitous, baffling, and consequential. One reason they are made badly is because people lack information about their choices. Properly informed, they would surely make better decisions. So let's require that they get the information they need. After all, when asked, consumers say they want information. Hence the basic axiom: more-information-is-better.

Not only is more information better, but the stronger parties have the information the weaker parties need. The stronger parties are unlikely to provide the information because the weaker parties' informational disadvantage often serves the interests of the strong. So let's make the stronger party provide the needed information. How can that not help? What can it hurt? Isn't it just requiring the stronger party to do what it ought to do without being compelled?

Mandated disclosure draws on ideas that have been prospering for a century. In 1914 Louis Brandeis, the "People's Lawyer" and later a Supreme Court Justice, stated the core mandated-disclosure argument in words that sound contemporary. Brandeis thought the law

“should not seek to prevent investors from making bad bargains. But it is now recognized in the simplest merchandizing, that there should be full disclosures . . . The Federal Pure Food Law does not guarantee quality or prices; but it helps the buyer to judge of quality by requiring disclosure of ingredients . . . Require a full disclosure to the investor of the amount of commissions and profits paid; and not only will investors be put on their guard, but bankers’ compensation will tend to adjust itself automatically to what is fair and reasonable. Excessive commissions . . . will in large part cease.”

Even a century ago Brandeis recognized some of mandated disclosure’s pitfalls but thought they could be side-stepped. He warned that

“the disclosure must be real. And it must be a disclosure to the investor. It will not suffice to require merely the filing of a statement of facts with the Commissioner of Corporations or with a score of other officials, federal and state. That would be almost as ineffective as if the Pure Food Law required a manufacturer merely to deposit with the Department a statement of ingredients, instead of requiring the label to tell the story.”¹

Disclosure’s axiomatic plausibility is enhanced by the rhetorical alternative. Disclosure connotes openness and transparency, contrasted with surreptitiousness and dark secrets. It connotes integrity, contrasted with corrupt and unaccountable governments. It is a disinfectant, a sanitizer, contrasted with the otherwise prevailing contamination and grime. It tells the full story, the reality, rather than hide it or deceive the audience. It is aimed at people, patients, consumers, workers, users—not bureaucrats or “a score of other officials.” It is the future of a fair society—not the archaic past of privilege and caveat emptor.

So at the core of mandated disclosure’s popularity is its intuitive plausibility. It seems hardly more than common sense to suppose that people would make better decisions if they were better informed and that they can be given information at the law’s command. Intuitively obvious as mandated disclosure seems in general, it seems even more plausible in the context in which lawmakers decide whether to mandate disclosures. In the next section we explore that context to see how the plausible – mandated disclosure – comes to seem inevitable.

B. THE AXIOM MADE FLESH: THE TROUBLE STORY

When lawmakers are asked to consider mandating disclosure, it is often in the context of a “trouble story”—a sympathetic tale of individual misfortune and

¹ Louis Brandeis, *Other People’s Money and How Bankers Use It* 103 (1914).

mistreatment that seems to represent a systematic problem in urgent need for legal redress. So the lawmaker hears about the family that lost a home to foreclosure, the credit-card user carrying unbearable debt, the patient whose treatment ended disastrously, the child who ate contaminated food, or the worker who was injured by a product. These trouble stories seem to present a common problem—an ill-informed decider—and a common solution—requiring the decider be given information. Even when a trouble story is not specifically presented to the lawmaker, a trouble story is likely to be in the lawmaker’s mind as a paradigm of what the law needs to address.

Trouble stories, then, help frame the regulatory question. And they do so in ways that drive lawmakers toward mandating disclosures, even when the argument for doing so is ultimately unconvincing. There are two principal reasons. First, trouble stories are dubiously representative. Second, trouble stories are seen through the distorting lens of hindsight. In short, trouble stories seem to confirm and certainly make vivid the axiomatic assumption that mandated disclosure is a broadly effective means of regulation.

Trouble stories fall in several rough categories: first, individual narratives; second, scandals; third, social crises. The “narrative” trouble story is exemplified by the saga of Jeanne Clery, a 19-year-old Lehigh student who was raped and murdered in her dorm room by another student. Clery’s parents “discovered a history of violent crime on their daughter’s campus of which students generally weren’t aware, and after hearing from the victims of violent campus crimes across the United States, they discovered that violence on college campuses was a widespread problem and devoted the rest of their lives to making campuses safer” The Clerys “cofounded Security On Campus, Inc., a national nonprofit organization . . . devoted to educating the public about campus security” This led to the Jeanne Clery Act, and “for the first time institutions of higher education across the United States began the process of consistently releasing crime statistics and security policies to their current and prospective students or employees”²

The “scandal” trouble story is exemplified by the Public Health Service research debacle at Tuskegee, where African American patients who contracted syphilis were studied but not treated. Tuskegee was the trouble story that inspired the creation of, and is still the primary and vivid rationale for, the university and hospital committees that now mandate elaborate informed consent disclosures for all human-subject research.

The “crisis” trouble story is exemplified by the series of apparently widespread problems with consumer credit. For example, Congress heard in 1998 the story of Mary and Earl Ranson, an elderly couple who sought to refinance their home to pay their medical bills. Confused about terms like “points,” “good faith estimate,” “appraisal fees”

² . H.RES.1609 (2010).

and “escrow” they ended up with mortgage at 19%, when cheaper credit was readily available and could have saved them \$37,000. Congress’ response? Congressman Lazio summed it up: “We in Congress have to look out for the Ransons and for all Americans by providing simple and easily understood disclosures.”³

Or, who hasn’t heard a trouble story about a consumer denied access to credit, work, insurance, or purchase because of an erroneous credit report? Lives have been destroyed by false information in credit reports, often the result of misreporting or identity theft. The 1970 Fair Credit Reporting Act creates obligations on credit bureaus to make effort to ensure maximum accuracy, and grants consumers rights to challenge false credit information. But it is often up to the aggrieved consumers to act when they feel that the credit report is inaccurate. To trigger consumer self-help, consumers have to know what their rights are and how respond to inaccurate reports. The trigger that the law uses is, again, disclosure. Creditors and employers must provide consumers “a clear and conspicuous disclosure . . . in a document that consists solely of the disclosure” that they are planning to obtain a report on the consumer. Likewise, consumers who complain about inaccurate reports are entitled to “a summary of rights” and “a statement that the consumer may have additional rights under state law.”⁴

Trouble stories drive lawmakers toward mandated disclosure partly because they drive lawmakers to act, to do *something*. This is particularly true of lawmakers in the legislative and executive branches who are vulnerable to political pressure. “Our political system is extremely sensitive to new calamities, real and imagined. The media thrive on stories of deaths and disasters; lobbying organizations, struggling to attract members and defeat opponents, have every incentive to exaggerate.”⁵ Such “[c]atastrophes are probably the most important catalysts of new regulation.” Legislators in our “media-oriented” world “transform individual acts of malfeasance into social problems requiring society-wide solutions.”⁶ Even courts are swayed by trouble stories. When a trouble story comes in the form of a case, it can evoke just as much sympathy and indignation in judges as in the public and just as strong a desire to act, to prevent the story from recurring. (We will shortly see two examples of this when we discuss two court cases, one dealing with medical informed consent and another with product risk disclosure.)

³ Statement of Representative Rick Lazio, Chairman of Subcommittee on Housing and Community Opportunity, July 22 1998, at http://commdocs.house.gov/committees/bank/hba50286.000/hba50286_0.htm

⁴ Fair Credit Reporting Act, Sec. 604, 609, 15 USC 1681g. (1970)

⁵ James Q. Wilson, *Bureaucracy: What Governments Agencies Do and Why They Do It* 341 (Basic Books, 1989).

⁶ Eugene Bardach & Robert A. Kagan, *Going By the Book: The Problem of Regulatory Unreasonableness* 23 (Transaction Publishers, 2002).

But trouble stories do not just create pressure to act. They tend to make mandated disclosure seem like a good way to solve the problem the trouble story appears to illustrate. Trouble stories have a feature in common: the weaker party in a relationship makes a decision that leads to misfortune. The stronger party had information that the weaker party presumably lacked. Had the weaker party made the decision with this information in mind, properly judged and applied, the misfortune would have likely been averted. Thus, to the question: 'would the misfortune have been averted had the decider been given information?' the implicit answer is typically 'yes.' Q.E.D.

The problem with trouble stories is that they make mandated disclosure look like a better regulatory choice than it usually is. This is partly because trouble stories are anecdotes and partly because trouble stories put problems in the distorting light of hindsight. Anecdotes are notoriously a poor basis for making policy. Good policy comes from a good understanding of the social situation being regulated. Trouble stories – like all anecdotes, rarely provide that good understanding. They are typically unrepresentative, rising from the tail end of the distribution of outcomes, and provide a misleading characterization of the social problem. To evaluate a story's representativeness, we need to know how many decisions of the kind regulation seeks to improve are made, and how many decisions are made badly. If only a tiny fraction of these decisions are made badly, legal regulation will rarely be cost-effective. For example, the Tuskegee scandal that gave rise to regulation of human subject research – do we know how often and how seriously are people injured by unethical medical researchers? Or by unethical social scientists? Even before the regulation of research and the requirement of informed consent were instituted, there was no systematic evidence of abuse, merely some anecdotes. But these are salient enough to stir regulatory action.

Even if the trouble story is true and representative of a significant proportion of the relevant kind of decision, we need to know whether the bad decision was caused by a lack of information and whether a different decision would have been made had the information been made available. Further, we need to know whether there is a practical way to write a mandate that will result in the information being provided adequately and used effectively. None of these questions is usually asked about the trouble stories that frame the question whether to mandate disclosures, for as Holmes said, "most people think dramatically, not quantitatively."

To put these points somewhat differently, trouble stories *may* tell us something about the *numerator*, but what is the denominator? We know that the problem happens sometimes, but do we know how often it does *not* happen? And do we know how many problems like it, equally solvable by additional disclosures, are likely to arise? How many separate items need to be disclosed? Thus, before we know which complaint or trouble the consumer might have, what is the correct scope of the disclosure rule?

Should every item that might, in retrospect, lead to regret, be separately disclosed? Can we rank which are more important? Which are likely to cause more disappointment?

The problem with trouble stories is not just that they are so dubiously representative. It is also that they describe decisions in the blinding light of hindsight. In the trouble story the protagonist has made a choice that turned out badly. In retrospect it is easy to see where the protagonist went wrong, to see how the victim could have avoided disaster by having the right information *and* using it correctly. Someone told about a peril would surely take steps to avoid it. Had you known your house would burn down by a lightning strike, you would have insured it. Had you known the fire would burn your business files, you would have added business interruption coverage. Had you known that the fire would hurt a neighbor, you would have added liability coverage. And so on, it is seductively simple to conclude that if only people knew in advance the risk that now, in hindsight, is known to have occurred, they would have taken the right action. No other regulation or intervention is necessary, only another bit of information.

The problem with hindsight, of course, is that you not only have the information you need to make an educated choice, you know how to analyze the information because you can see which information would be relevant and what the result of a decision would be. You know not only the odds of a result; you know that it is going to occur.

Let us make this abstract discussion more concrete with an actual trouble story – *Truman v. Thomas*¹ – which led an actual lawmaker to expand an actual mandate. Dr. Truman was Mrs. Truman's primary physician. He urged her to have a Pap smear but never explicitly told her the risks of *not* having one. She died of cervical cancer. An expert testified that if she had had a Pap smear while Dr. Truman was caring for her “the cervical tumor probably would have been discovered in time to save her life.” The law of informed consent required doctors to tell patients about the risks and benefits of treatments, but it was generally not understood to require them to tell patients about the risks and benefits of *untaken* treatments or screening tests.

So, Mrs. Truman made a decision – not to be screened – that, made differently, might have kept her from dying. Her doctor had not expressly told her that that death was a possible consequence of her decision not to be screened. In response to this trouble story, the California Supreme Court essentially expanded doctors' duty of disclosure to give information to people like Mrs. Thomas so that they would “appreciate[] the potentially fatal consequences of [their] conduct.”

¹ 611 P2d 902 (California 1980).

The California Supreme Court seems to have accepted the position of the dissenting judge on the Court of Appeal: "Can it be doubted that, had the decedent in this case known that for \$6 and mild discomfort she could discover the existence of cervical cancer and thus survive, she would have taken the test? Central to her failure to take the test was a clear lack of understanding of the significance of the doctor's recommendation."

How does this trouble story look as a basis for expanding a disclosure mandate? How many woman have a doctor who should be advising them to have a Pap smear? How many of these women decline?⁷ Or are these the right numerator and denominator? The court mandate will presumably cover screening tests of all kinds. And since doctors have more things to do with patients than they have time to do, perhaps the best denominator is the full set of disclosures of all kinds doctors ought to be obliged to make to patients.

How much is the court's interpretation of this trouble story biased by the court's knowledge of how the story ended? Dr. Thomas had in fact been on a prolonged campaign to get Mrs. Truman to accept the Pap screening and other screening. A few examples: When she came to see him with an upper respiratory infection, he suggested "a Pap smear, but Mrs. Truman said she did not feel like it." He told her more than once that he would not prescribe birth control pills "unless she had "a pelvic and a pap smear." She promised that she would but then kept putting him off. When she said she couldn't afford a test, he offered to defer his fee. Dr. Thomas was not the only doctor who failed to persuade Mrs. Truman to accept medical care. When she finally saw a urologist, he told her how serious he thought her condition was and told her to see a gynecologist, but she did not. The urologist saw her three more times, but each time she put him off. Finally, the urologist himself arranged for Mrs. Truman to see the gynecologist, who diagnosed her disease."

In hindsight, a warning about the risk of Pap smear seems so valuable that it overshadows everything else the court knows about that happened between the doctor and the patient. In the case of Truman v. Thomas, it is hard to imagine what difference the warning would have made. Did the doctor truly fail to give the patient information? Would a correct statement of the odds of the Pap smear saving her life, as well as the other tests Dr. Thomas wanted performed, have changed her behavior when all these other measures did not? And is a mandate to disclose screening statistics when they are relevant to a patient's decision the best way for the law to regulate doctors' dealings with recalcitrant patients? Is it the best way to help patients reach sound risk-benefit decisions?

⁷ In the United States 82.8% of women over 17 report having had a Pap smear within the last three years. www.statehealthfacts.org/profileind.jsp?rgn=1&ind=482&cat=10.

In the trouble story of *Truman v. Thomas*, the court had naïve ideas about the value of information and failed to recognize the hindsight bias. But even sophisticated lawmakers who recognize the numerator and denominator problems may succumb to the lure of mandated disclosure. For example, the Federal Trade Commission has a staff of experts, and its commissioners serve terms long enough (seven years) to acquire considerable experience. The FTC regulates both “deceptive” and “unfair” commercial practices, which gives it authority over warnings for users of products like vehicles, drugs, and tools. In a famous ruling,⁸ the FTC examined warnings International Harvester had given tractor users. Removing a hot engine’s fuel cap could cause “fuel geysering”—an eruption of burning hot fuel. In the early models, IH did not warn against cap removal and some people were seriously injured. Later, warnings were added to the operator’s manual of new models, but the older manuals were left unrevised, and the problem of geysering was not fully explained even in the new warnings. Was IH’s failure to spell out the exact nature of the hazard “deceptive” or “unfair” and was a more comprehensive disclosure mandate warranted?

The Commission decided (against vigorous dissent) that IH’s failure to disclose the full detail of the geysering risk was *not* deceptive because geysering was rare and injury rarer. The FTC knew the trouble stories—of severe injuries suffered by tractor operators who removed sizzling fuel caps. The FTC also (optimistically) assumed that a warning, if (somehow) effectively communicated to tractor operators, would have prevented the injuries. The Commission also understood the denominator problem: Over 1.3 million tractors had been sold and been run millions of times over 40 years, and only 12 serious geysering-related injuries (including one death) had been reported.

The FTC also saw the denominator problem in its broader context. Many other features of a tractor can cause serious but rare injuries. Requiring warnings about geysering and all other similarly serious but rare risks would present consumers with more writing than they would read or could assimilate. The Commission recognized that Individual consumers may have erroneous preconceptions about issues as diverse as the entire range of human error, and it would be both impractical and very costly to require corrective information on all such points. ... The number of facts that may be material to consumers—and on which they may have prior misconceptions—is literally infinite. ... Since the seller will have no way of knowing in advance which disclosure is important to any particular consumer, he will have to make complete disclosures to all. A television ad would be completely buried under such disclaimers, and even a full-page newspaper ad would hardly be sufficient for the purpose. For example, there are literally dozens of ways in which one can be injured while riding a tractor, not all of them obvious before the fact, and under a simple deception analysis these would presumably all require affirmative disclosure.

⁸ 104 F.T.C. 949 (1984).

So despite the more-information-is-better mantra and the distorting effects of hindsight, the FTC calculated the denominator, recognized the microscopic rate of risk, and held that the failure to explain in full the hazard of geysering in the operator's manual was not deceptive.

Nevertheless, sympathy trumped sense. With no dissent, the FTC announced that failing to disclose the fuel-cap problem in the user manual, while not deceptive, was nevertheless "unfair" to consumers. In determining whether failure to warn is unfair, the FTC took special notice of the actual injuries. Here, the lawmaker succumbed again to the trouble story pattern. It described in detail the burn injuries that 11 victims suffered, their post-injury trauma and psychological harm, and their bodily disfigurement. Mysteriously, the concern about information overload vanished: "the consuming public has realized no benefit from Harvester's non-disclosure that is at all sufficient to offset the human injuries involved." Thus, even a sophisticated lawmaker, recognizing the denominator problem and the microscopic probability of harm—less than one one-thousandth of one percent— could not resist mandating disclosure.

In sum, the account of trouble stories as engines for regulation explains not only why mandated disclosure is used so often. It also begins to provide a glimpse as to why mandated disclosure so often fails. Trouble stories create pressure to act when there is no problem to solve or a problem that cannot be solved without spending more on the solution than you gain from it. Trouble stories create an urgency to act quickly rather than effectively. Trouble stories lead people to imagine that mandated disclosure will work when it is unlikely to, not least because a story seen in hindsight so greatly distorts the law-maker's view of the situations in which the mandate would be applied.

C. THE UNFALSIFIABLE AXIOM

We have argued that lawmakers tend to see mandated disclosure as a presumptively sensible solution to the problems for which it is used and that this assumption tends to be confirmed by the trouble stories through which problems are presented. But why hasn't the repeated failure of mandated disclosure compelled lawmakers to abandon this assumption?

A preliminary reason is that mandated disclosure has not been recognized as a recurring regulatory technique with common forms, common results, and common problems. Scholars have therefore not evaluated mandated disclosure as a technique. The scholarly evidence is primarily about mandated disclosure in specific fields. Lawmakers are thus not presented with a body of evidence suggesting that mandated disclosure is an unreliable regulatory method.

But the durability of the mandated disclosure species owes to a deeper reason: the idea of disclosure, of transparency, of the right-to-know and to make informed decisions is non-falsifiable. Even when disclosures fail, their failure can be explained as

a defect in implementation, not method. Failure only means that the disclosure mandate should be reengineered: expanded, modified, simplified, tightened, emphasized, shifted in time, repeated, or supplemented by education.

This process follows familiar patterns. The first reaction to a mandate's failure is that people are still making bad decisions because they still aren't getting enough information. Perhaps they didn't understand the disclosure because it needed to be explained more fully. Surely there is always more information that would be relevant to a difficult decision. This attempt to explain things more thoroughly often leads to the realization that people are drowning in information and that disclosures need to be simplified. Later, other tactics—not to say, gimmicks—begin to look crucial: mandating earlier disclosures to give people time to read them; mandating later disclosures to give people a chance to appreciate their relevance; defining new ways to present the same information; aggregating information into simpler parameters; unifying separate disclosure forms; separating unified disclosure forms; providing clearer bottom lines; requiring plain meaning language; increasing the print font; using black “boxes” (bold rectangle wrapping the disclosure text); and much more.

The unfalsifiability of mandated disclosure is illustrated by the striking fact that no amount of experience and crises has convinced lawmakers that disclosures will not keep consumers from contracting irrational and devastating debt. The Truth in Lending Act and its satellites are perhaps the most comprehensive and elaborate disclosure regime in American history, one of the crown jewels of Federal consumer protection legislations. That regime has long required a long list of pre-closing mortgage disclosures. Despite all the disclosures, we have recently undergone an epidemic of subprime and predatory lending, a surge of foreclosures, and a major financial crisis. Yet commentators, reformers, and lawmakers aplenty still consider disclosures a core solution.

In fact, as we write this book, the Obama Administration is considering how to revise basic consumer financial protections, given the new and unprecedented reform mandate it received from the public and from Congress in the Dodd-Frank Act. Secretary of the Treasury Timothy Geitner announced that the new consumer financial protection bureau would continue to dedicate itself to “improving” the most common yet least successful regulatory technique in American law. Disclosure, Secretary Geitner said in 2010, “is one of the most powerful tools we have for getting people better information so they can make better choices about how they borrow, how they use credit, how they invest their savings.”

D. THE AXIOM AND THE FISC

Mandated disclosure, we have said, seems so plausible that its effectiveness is virtually axiomatic. And when problems are presented to lawmakers through the kinds of trouble stories we have described, that axiom is given new life and force. But

mandated disclosure is an attractive regulatory technique for yet another reason – it leaves the fisc unmolested. From the government’s point of view, that is, it’s *really* cheap.

Mandated disclosure costs the government little because it requires minimal budget, bureaucracy, or oversight—perhaps only a small bureau writing and interpreting regulations. Disclosure regimes do not require the complex procedures government agencies have to follow for rulemaking under administrative law, which include pre-publication, public comments, cost-benefit analysis and a preparation of formal Regulatory Impact Analysis. The (sometimes onerous) costs of writing, distributing, and using disclosures are not borne by the government. Better, those costs seem to be imposed on the story’s villain, the stronger party who withholds information and now must do its simple duty and reveal it. For example, the Truth in Lending Act, which was originally written in 1968, obliged the Federal Reserve Board only to issue occasional interpretations to clarify the law. The burden of this regime falls on creditors, and even enforcement is significantly delegated to private parties.

In contrast, the alternative ways of regulating the kinds of problems to which mandated disclosure is addressed can truly burden the government. The problem is generally not the absence of alternatives to mandated disclosure. In consumer-credit regulation, for example, the government can deploy a considerable repertoire of ways of repairing market failures and protecting consumers. The government can improve access to credit, enforce usury statutes, prohibit discrimination, punish abusive collection tactics, regulate credit-reporting data and privacy issues, administer licensing regimes, and even regulate the terms of mortgages and credit contracts. The government can also subsidize credit to the poor, or otherwise use fiscal measures to affect credit markets. But these are risky strategies because they can fail in damaging ways and because they can be expensive to set up and run. In short, mandated disclosure is usually cheap and the alternatives often expensive.

Even the few costs mandated disclosure imposes on the government can often be kept modest because – truth be told – mandates are often written sloppily. Because lawmakers attempt to cast a broad net over the issue and to require comprehensive disclosure of information, the requirements can be complex, technical, overly broad, and often vague. Colleges often struggle with the puzzling inconsistencies in the Clery Act mandates, and inspectors concede that they can never find a campus in complete compliance. TILA and regulations implementing it were so complex and technical when first enacted, so sweeping in their definitions, requirements and nuances and so difficult to comply with, that they had to be overhauled and simplified soon after the original enactment, and frequently since. IRBs and commentators repeatedly beg OHRP to clarify the way IRBs should administer disclosure programs, but answer comes there none.

The fiscal attractions of mandated disclosure are helpfully illustrated by lawmakers' reaction to the trouble story of Jeanne Clery's rape and death. Lawmakers should first have asked whether campus safety is actually a more significant problem than safety in any other place (we have no idea whether it is, although we like the idea of safe campuses very much). Assuming they thought campus safety required special attention, lawmakers could have decided to require or help schools to make their campuses safer. This could have meant discomfiting government expenditures. Police might have been hired, prisons might have been built, safety standards might have been set and enforced, subsidies might have been provided. This would inevitably have affected governmental budgets but would not necessarily have improved campus safety.

In fact, lawmakers chose to treat the trouble story not as a problem in campus safety but rather as a problem in people's choices of what school to attend or work for. Thus all the lawmaker needed to do was require schools to provide the information that would inform those choices. The federal government publishes a handbook—here, a one-time 200-page brochure of instructions how to provide campus safety reports—and leaves the rest for colleges and their students. Compliance with the disclosure may be expensive—a typical Clery Act disclosure is over 10,000 words long and requires much data management by disclosers, but these costs are not funded by the government.

E. THE AXIOM AND THE ART OF THE POSSIBLE

Politics is often called the art of the possible. Mandated disclosure is used and over-used because it is – as these things go – a lot more possible than most of the alternatives. Mandated disclosure is politically easy to put into law; alternative kinds of regulation are often quite hard to put into law.

Sometimes, mandated disclosure is the lawmaker's most desired go-to policy. We saw that it is often the first response to a trouble story. Lawmakers' can usually be confident that that response will provoke little opposition while it tends to tame whatever pressures there may be for the lawmaker to act. But often, mandated disclosure is the result of a law-making process that began with more ambitious regulatory plans. What candidate campaigns with promises just to mandate and improve disclosures? Lawmakers promise their voters plans and reforms with more zest and more ambition. Depending on their ideological commitments, some lawmakers promise reforms that will secure meaningful protections against ruthless market behavior, or more energetic redistribution. Other lawmakers promise to fight for free, deregulated markets, low taxes, and fewer government mandates. Some promise government spending, others promise tax breaks. More government versus less government. Efficiency versus redistribution. Laissez Faire versus Obama Care.

But when campaigns and elections are over and it's time to legislate, the political stalemate between the competing agendas cancels out many of the more ideologically

ambitious, risky, and costly reforms. It takes enormous political capital to enact meaningful regulation or to eliminate existing regulation. Either way, a strong and vocal opposition of interests and political muscle stands in the way of the reform, and judicial review is likely to follow. Instead, a compromise can be drafted. It mandates new disclosures.

Disclosure laws can be politically attractive solutions to social questions partly because lawmakers rarely inquire into the effectiveness or burden of the mandates. When Congress enacted the Patient Self-Determination Act—a disclosure statute intended to induce people to make advance directives and living wills—“only limited discussions of the potential costs and benefits of the PSDA occurred during the legislative process.”⁹ Similarly, the courts that primarily created the duty of informed consent barely asked whether patients wanted to make medical decisions, whether doctors could provide and patients could comprehend the mandated information, whether patients would make better decisions with that information, whether the mandate could be stated in a way doctors could understand, or what informed consent would cost—despite empirical grounds for expecting troubling answers to these questions.

Disclosure laws, then, are easy because lawmakers do not need much information, do not need to make trade-offs, and need not worry about damaging other parts of the economy. As laws go, these mandates are compact: They address a problem comprehensively but need not interfere with other activities. Disclosure laws are cathartic. They provide a pleasing sense of accomplishment, of resolution, of cleansing. An extravagant example is the reaction of Senator Danforth’s assistant after he successfully secured the passage of the PSDA. She thought “Reinhold Niebuhr would have enjoyed watching the legislative process,” because translating “a good idea into a good law is . . . a Niebuhrian dream.”¹⁰

Mandated disclosure is the ultimate political compromise because it does not offend and often cosmetically bolsters the two fundamental political ideologies. The first political ideology is that of free-market principle, Laissez Faire, and deregulation. Call it, if you want, the Republican Party. Mandated disclosure may constrain unfettered rapacity and counteract fraud and deception, but the intervention is soft and leaves everything substantive alone: it does not set prices, it does not mandate minimum quality standards or production processes, and it does not regulate entry, product allocation, or licensing. Instead of specifying outcomes of transactions or

⁹ Jeremy Sugarman et al., The Cost of Ethics Legislation: A Look at the Patient Self-Determination Act, 3 **Kennedy Instit. Ethics J.** 387, 389 (1993).

¹⁰ Elizabeth Leibold McCloskey, *The Patient Self-Determination Act*, 1 **Kennedy Inst of Ethics J** 163, 164 (1991).

dictating choices, it proffers information for making better decisions.¹¹ Businesses are free to compete, people are free to choose and take risks, parties are free to write their own contracts, and no government entity appropriates any of the basic market liberties. In fact, even avid libertarians and free-marketeers will concede that markets need good dissemination of information to be functioning and efficient. People have to make rational informed choices, not guesses. Uninformed consumers make poor decisions and can cause market misallocations. Disclosure of information, then, is not a concession but rather a goal of the free market agenda.

Mandated disclosure is also close to the heart of the opposite political ideology – the progressive tradition that seeks to secure minimum prosperity and autonomy for people, along the liberal, consumer protection, civil-right agenda. Mandated disclosures give consumers the tools to make better decisions and to guard against exploitation and oppression. It thus serves the utility and autonomy of everyday people. Mandated disclosure replaces the market-based voluntary disclosure approach. It contrasts with the notorious caveat emptor – each party on its own. It is a form of regulation, setting minimum standards relating to the substance of the information required and providing potentially stiff sanctions for violations. It is therefore an important element of any regulatory scheme that intends to substitute unfettered market competition with a framework that promotes better outcomes for the less privileged people.

The disclosure paradigm fits well with more than just the two main political ideologies. It seems to fit with almost every political and normative belief. Disclosure is the foundation of individual autonomy, one of the ultimate justifications for the informed consent and IRB research regulation regimes. Disclosure promotes economic efficiency and growth, solving market failures, and—as the Federal Trade Commission says—“it is a basic tenet of our economic system that information in the hands of consumers facilitates rational purchase decisions; and, moreover, is an absolute necessity for efficient functions of the economy.”¹² Disclosure is also ethical, and so conflict of interests disclosure is “a basic requirement of the fiduciary nature of the treatment relationship.”¹³ Disclosure fights corruption, hence Justice Brandeis’ famous observation that “sunlight is said to be the best of disinfectants.” Indeed, mandated disclosure is all that is left of campaign finance regulation, standing alone as the ultimate guardian against election corruption.¹⁴ Similarly, disclosures by labor union are

¹¹ See the excellent discussion in Beales et al., at 513; see also Colin Camerer et al., *Asymmetric Paternalism*, 151 *U Penn. L Rev* 1211, 1212 (2003).

¹² Statement of Basis and Purpose, Labeling and Advertising of Home Insulation, 44 Fed. Reg. 50218, 50222 (1979)

¹³ Mark Hall, *Making Medical Spending* 198; Martin Grunderson, *Eliminating Conflicts of Interests in Managed Care Organizations Through Disclosure and Consent*, 25 *J. L. Med. & Ethics* 192, 195 (1997).

¹⁴ “Disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way.” (Citizens United).

a vehicle to fight corruption, so “that members' funds are not being misappropriated by those to whom the funds have been entrusted.”¹⁵ Disclosure is equitable, because it gives everyone the same opportunity to be informed and exposes hidden practices of unacceptable discrimination that impoverish the least well off.¹⁶ And disclosure also builds “civic empowerment” by allowing people to use knowledge for advancement of competing agendas and participate in the various circles of their society.¹⁷

The appeal of mandated disclosure to the entire spectrum of political values is nicely summarized by Sunstein and Thaler’s notion of Libertarian Paternalism—a public policy that is both liberty preserving and paternalistic. Mandated disclosure is the ultimate libertarian paternalistic measure. Libertarians should like it because no choices are blocked. People can smoke if they want, or take bad mortgages. Paternalists should like it because lawmakers, as architects of public choice, can design specific language in the disclosures to channel people in directions that lawmakers believe will make people better off. Sunstein and Thaler are confident that Libertarian Paternalistic policies are “a promising foundation for bipartisanship,” being “neither left nor right, neither Democratic nor Republican.” They “might appeal to both sides of the political divide” and “can be embraced by Republicans and Democrats alike.”¹⁸

That mandated disclosure appeals across the political spectrum is shown not only by the superabundance of disclosure laws. It is also shown – dramatically – by the margins of political support by which disclosure statutes are enacted. The Truth in Lending Act—the mother of all disclosure statutes in the consumer credit area—passed in the Senate by a majority of 92 to 0 and in the House by 382 to 4. It was preceded by a potpourri of state “mini-TILA” statutes, which also received widespread support. For example, Illinois’ mini-TILA was approved in 1963 by the Illinois Senate in a vote count of 56 to 1. The Fair Packaging and Labeling Act passed 72 to 9 in the Senate and 300 to 8 in the House. The Clery Act went through the House “without objection.” The Real Estate Settlement and Procedure Act (RESPA) – an important 1974 supplement to TILA and the ultimate federal disclosure statute for mortgage lending—passed in the Senate and the House by unanimous consent. The Magnusson-Moss Warranty Disclosure Act, which requires standard disclosures and clear language in product warranties, passed in the House of Representatives by a majority of 381 to 1. And more recently, the Credit CARD

¹⁵ *AFL-CIO v. Chao*, 409 F.3d 377, 392-94 (disclosure “would properly ensure union democracy, fiscal integrity and transparency in a manner consistent with the intent of Congress in enacting the LMRDA.”)(Roberts. J)

¹⁶ *Fung et al*, 40.

¹⁷ For example, Congress thought that disclosure by unions of their leaders finances and activities would “provid[e] union members with useful data that will enable them to be responsible and effective participants in the democratic governance of their unions.” (67 Fed. Reg. 79, 280-281).

¹⁸ Cass Sunstein & Richard Thaler, *Libertarian Paternalism*, 70 *U. Chi. L. Rev.* 1159, 1160 (2003); Nudge, 5-14.

Act of 2009, which provided stronger disclosures to protect credit card users, passed by votes of 90 to 5 and 357 to 70.

Even health care reform—one of the most politically divisive issues in America—attains a consensus when it mandates disclosure. When the Obama administration launched the Patient Protection and Affordable Care Act of 2010, the political divisions could not be any more bruising. But when the Obama administration was poised to mandate disclosure of drug companies' payments to doctors for research and consulting, bipartisanship reigned. Legislation that will "permit patients to make better-informed decisions when choosing health care professionals" was championed by both parties, and Republican Senator Charles Grassley announced that "the goal is to let the sun shine in and make information available to foster accountability."¹⁹

This is not normal. Everything else is contested, from Medicare laws to 9/11 compensation funds. Even consumer-protection legislation is quarreled over and achieves, at best, narrow partisan majorities. For instance, the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, which created the Consumer Financial Protection Bureau and a framework for prohibitions on abusive credit practices, passed along party lines: 223 to 202 in the House, 59 to 39 in the Senate. Or, the Home Mortgage Disclosure Act, which, despite its name, is not merely a disclosure statute but rather a reporting tool used by government in distributing public sector investments and in identifying discriminatory practices, passed by tight votes of 45 to 37 and 177 to 147. Business interests would normally fight and resist regulations, but as one creditor said candidly, "I would rather disclose than be regulated. Everything you want me to disclose I can accommodate."²⁰ As Lauren Willis recounts, in 2003 legislators proposed consumer financial protection reforms. Bills that protected homebuyers from predatory lending or capped the price of payday loans never even received a subcommittee hearing. But a bill establishing the Financial Literacy and Education Commission became law in less than three months.²¹

A similar dynamic operates outside as well as inside legislatures. Take, for example, the battle over reform of the law governing software contracts. For over a decade several versions of new statutes were proposed by rule making bodies, aiming to either increase the rights of end users or to provide greater immunity to software licensors. Statutes that took strong positions – either protective or permissive – failed. They were either thwarted at the drafting process through aggressive lobbying by interest groups or, if drafted, failed to receive the necessary support for enactment into

¹⁹ U.S. to Force Drug Firm to Report Money Paid to Doctors, by Robert Pear, New York Times, January 16, 2002.

²⁰ Statement of Robert F. Elliott, President, Household Finance Company, in Re-examining Truth-in-Lending: Do Borrowers Actually Use Disclosures? 52 Consumer Finance L. Quar. Rep. 3, 7 (1998)

²¹ Willis, Against financial Literacy Education, 94 Iowa L Rev 197, 265 (2008).

state laws. Finally, an initiative by the American Law Institute to state the “Principles of Software Contracts” succeeded. It is striking, however, that the main reform agreed to in these Principles is increased disclosure. Software contracts can continue to regulate the rights of licensees with almost no constraint, but the fine print must be adequately disclosed.

Our informal conversations with those involved in the reform efforts further suggest that disclosure was the only feasible compromise. The Reporters wanted to do more, but faced with fierce interest groups’ opposition, they had to back away from the ambitious agenda and settle for mandated disclosure. Once the compromise was set, the standard rationales were invoked. Thus, Principles explain that mandating disclosure is wise on a host of normative and policy grounds. Disclosure serves “economic efficiency,” “fair” prices, the spirit of “sharing,” and the “principle of autonomy.” If these are not enough, the drafters also believe that “disclosure is a matter of right and wrong.” It is morally impermissible to take advantage of someone’s ignorance, and it “violates respect for persons.”²²

F. WHY EVEN GOOD MANDATES TURN BAD

We come now to one of the most important features of mandated disclosure. We have never argued that mandated disclosure always fails. We have provided examples of disclosures that appear to be working, like the restaurant sanitation ratings. Crucially, however, even apparently effective mandates tend not to remain so. This is principally because lawmakers broaden the mandate’s scope past the point of usefulness. That is, lawmakers tend to diminish and even destroy modestly successful disclosures by requiring that more data be disclosed and that data be explained more thoroughly.

The dynamics of disclosure, in short, are that mandates almost never shrink; they almost always grow. This is critical, because long disclosures are unlikely to be read and even less likely to be readable. Examples of this dynamic abound. We produced in Chapter 2 an exhibit of the *California Retail Installment Sale* form—the standard form contract that integrates all the disclosures handed out to consumers who buy new cars on credit. Today, it is a grotesque collage of numerous disclosure condensed into two triple length pages, 5400 words in all. But this is not how it was conceived. No sane lawmaker would have drafted such a caricature. Originally, in 1961, it was just a single page, not a “bed sheet.” Then, when the California legislature launched the original version, it looked like this:

Since then, the original 4 separate disclosures ballooned to 16. The 2 separate signatures (one for the entire deal, and one for a additional insurance) grew to 8. The 4 different fonts have now become 22 different fonts and typefaces. The 11 blank spaces

²² Hillman and O-Rourke, 2011, University fo Chicago Law Review

to break down the price have multiplied to 60. And the 740 original words have expanded to 5400.

The bed sheet is so stunning in its illustration of the evolution of disclosures that one might be tempted to dismiss it as non-representative. Sadly, the landscape is abundant with similar engorged disclosures. Another telling illustration comes from the IRB system. There the regulator (the IRB) approves the exact words of every disclosure—every informed consent form distributed to prospective research subjects. The literature, government agencies, and elite commissions have long agreed that the consent forms are too long. Nevertheless, in the decades in which the IRB system has regulated the ways researchers may solicit consent from, these forms have lengthened steadily and remarkably.

In one study, for example, consent forms grew “roughly linearly by an average of 1.5 pages per decade. In the 1970s, the average consent form was less than one page long and often only a paragraph or two, but by the mid-1990s the average form had increased in length to over 4.5 pages”²³ Another study “demonstrated that the mean length of consent forms nearly doubled between 1975 and 1982.”²⁴ The universality of the dynamics of disclosure are suggested by an Australian finding “that the median length of consent forms increased from seven to 11 pages between 2000 and 2005.”²⁵

Why do disclosures that originate in formats calculated to serve their pragmatic purposes almost inevitably expand so that they can no longer work effectively? In large part, for the same reasons we have just given for the profligate use of disclosure mandates. All the things that drive lawmakers toward using growing numbers of mandated disclosures drive them toward expanding the length and scope of individual disclosures. Indeed, the more successful a disclosure is, the more the lawmaker is encouraged by the initial success to think that it has hit on regulatory device that works and that therefore should be recruited to do more work.

On the other hand, suppose that a mandate fails to achieve the goals set for it. This means that the social problem will remain, trouble stories will still occur, and pressure to do something will persist. Because, as we said earlier, mandated disclosure is unfalsifiable, expanding the disclosure will seem like a perfectly reasonable way to fix its original ineffectiveness, patch the remaining ruptures in peoples’ knowledge, and close new loopholes exploited by the sophisticated counterparts.

²³ Ilene Albala et al, *The Evolution of Consent Forms for Research: A Quarter Century of Changes*, 32 IRB: Ethics & Human Research 7 (May/June, 2010).

²⁴ Ibid.

²⁵ Ibid.

Disclosures not only evolve over time, they do so asymmetrically. Changes in mandated disclosures occur primarily in one direction—toward more language, more items, more detail, more often. New conditions, new problems, and new injuries propel new disclosures and new versions of old disclosures. In a symmetric world, this would be offset by a counter effect: problems that no longer happen, conditions that improved, and injuries that no longer occur would lead lawmakers to scale back disclosure mandates. In such a symmetrical world, disclosure mandates would enter and exit through the regulatory revolving door.

But the engine that triggers new disclosures is more powerful, salient, and politically focused than any pressure to scale back stale mandates. Social problems and trouble stories attract attention. What would attract attention to the absence of social problems and trouble stories? What event might induce lawmakers to revoke unnecessary disclosures? What would count as evidence that the problem was infrequent and minor, no longer worthy of mandated disclosure? Which interest groups would push for and trigger such reform? The pressure for *more* is salient, politically charged, and urgent; the pressure for *less* is diffuse, abstract, and mild. This *ratchet* effect is independent of a disclosure's success. If problems persist despite a mandate, new disclosures are added to the old ones to combat the unrelenting enemy. If problems dissipate, disclosure mandates are preserved as necessary to keep the problem from returning. It is hard to imagine a scenario in which a disclosure mandated is simply extinguished.

Recall the fuel-geysering problem. There, 1,300,000 tractors were sold and operated for years, and only 12 serious injuries were documented. The numerator of 12 provoked trouble stories; the denominator, which included an additional 1,299,988 cases without trouble was not large enough to prevent the FTC from requiring disclosure. Even if the numerator reached zero, would the FTC revoke its mandate? Would a new procedure be launched to investigate whether the mandated disclosure outlived its usefulness?

The same dynamic is in place when disclosures respond to changing conditions. New technologies, new environments, new hazards—all may necessitate new disclosures or additional information in an already existing disclosure. New drug side effects become known, more types of creditor abuse needs to be warned against, additional fees have to be disclosed, endless privacy leaks to close. The complexity and length of the disclosure grow step by step with the new conditions. But not vice versa: there is never an obvious ingredient to delete. Unlike new conditions, which arrive at the political stage in a salient and often dramatic and startling fashion, old conditions dissipate in a quiet, gradual, lengthy, movement. There seems to be a natural time to act, but never a natural time to un-act.

In the end, the lawmakers that mandate disclosures (and the disclosers who expand their disclosures) run little risk of political harm. If a lawmaker has trimmed or

revoked a mandate, and yet a trouble story later occurs, the lawmaker may have to explain why it left unprotected the consumer who would (in hindsight) have benefitted from the stale disclosure. But who will reward the lawmaker who repealed an obsolete mandate, for the sole purpose of reducing the politically invisible information clutter?

Chapter 8 At Worst, Harmless?

Disclosure is also inexpensive and, at worst, harmless.

Robert Hillman & Maureen O'Rourke, Reporters
ALI Principles of Law of Software Contracts
Defending Disclosure in Software Licensing

A. THE HARMLESSNESS HYPOTHESIS

Hillman and O'Rourke recite one of the most common and consequential ideas about mandated disclosure—the harmless hypothesis. As Justice Stephen Breyer wrote once, disclosure is such a popular alternative to direct regulation, despite often being ineffective, because “at worst, too much information, or the wrong information, has been called for.”²⁶ We hear this aphorism ourselves: “Well sure, mandated disclosure rarely works, but it’s cheap and harmless, so why get worked up about it?”

Sophisticated disclosurites know that mandates have performed badly. Hillman, for example, whom we cite here for a recent harmless statement, has in the past commented on disclosure’s potential harm. Regulators who have struggled with truth-in-lending mandates have conceded how persistent problems have been despite decades of mandates. Likewise, the National Research Council—whose mission is to improve government decision making and public policy—has acknowledged that “[d]espite decades of research on consent issues . . . there appears to have been little progress in devising more effective forms and procedures for achieving informed consent”¹

Nevertheless, these sophisticated observers, advisers, and regulators urge us forward to more and better disclosure. Battle after battle is lost, but support for the disclosure paradigm remains robust. How is it that so many enlightened and well-intentioned people so stubbornly persist in failure? Partly because they believe, or tacitly assume, that disclosure can do no harm. The harmless hypothesis, it turns out, accounts for much of mandated disclosure’s perseverance. In this chapter, we will review and reject this harmless hypothesis.

Disclosurites usually concede that mandated disclosure has costs, but they believe that it is nevertheless a no-lose enterprise. We suspect that what underlies this

²⁶ Stephen Breyer, *Regulation and its Reform* 161 (1982)

1. National Research Council, *Protecting Participants and Facilitating Social and Behavioral Sciences Research* 2-3 (The National Academies Press, 2003).

position is a combination of the more-information-is-better mantra—the assumption that if you strew enough information in people’s paths they will pick up some and use it profitably—as well as a rough judgment that disclosure is so “inexpensive” that even modest benefits would the costs. At the same time, the acknowledgment that mandated disclosure imposes even modest costs suggests that it can only be harmless if the benefits outweigh these costs. As we have argued throughout this book, the costs of issuing mandates, disclosing mandated information, and using disclosed information effectively generally outweigh the wispy benefits of mandated disclosures. A regulation that costs more than it delivers is virtually the definition of bad regulation, of regulation which at the least wastes social resources. This alone challenges the harmlessness hypothesis.

In this chapter, we want to raise the stakes. We examine another set of reasons mandated disclosure is not “harmless.” Disclosures not only incur costs; they actively do harm. This harm is unintended and unnoticed. But harm there can be, and in several forms. Mandated disclosure can make regulation worse; it can make people’s decisions worse; it can do harm to markets; it can society worse; and in some important scenarios, it can be lethal.

B. MAKING REGULATION WORSE

This is a book about regulatory choices and about the overuse of one such choice. In this section, we argue that mandated disclosure has led lawmakers toward harmful regulatory choices of two kinds: first, precluding better regulations; second, impairing existing regulations.

Lawmakers, like doctors, prescribe treatment for problems. Two kinds of problems can ensue from a misjudged prescription. First, an inappropriate medication can undermine other treatments. Likewise, mandated disclosures sometimes undermine the protective effect and other legal remedies. Second, the “mission accomplished” phenomenon: once a treatment has been ordered, alternatives tend to be ignored. When lawmakers have mandated disclosures, they can more easily escape the unpleasantness of considering other—perhaps better—regulation. Thus bad law drives out better.

Undermining Existing Regulation

Mandated disclosure can displace and undermine other forms of regulation. This is a subtle and little recognized effect and thus deserves several examples.

For instance, disclosures diminishes courts’ ability to protect injured consumers. Consider hazard warnings—a form of advisory, not strictly mandatory, disclosure—which, if not given, could lead to liability and sanctions. Manufacturers sometimes choose between designing a product to minimize risks versus warning users

about a product's risks. Warnings place the responsibility for accidents on the users. The Restatement of Torts explains that "when adequate warning is given, the seller may reasonably assume that it will be read and heeded; and a product bearing such a warning, which is safe for use if it is followed, is not in defective condition, nor is it unreasonably dangerous."²⁷ The manufacturer—who could otherwise be liable for designing an unsafe product, for marketing it irresponsibly, or for failing to provide other forms of protection—escapes liability because users could have read and followed the warnings.

Of course people should accept some responsibility, examine packaging, beware of sharp moving parts, and heed conspicuous cautions. But tort law expects people to go beyond that and read the fine print, package inserts, and catalogs of instructions on safe usage. It matters not that some products come draped in dozens of warnings. (We are thinking of the aluminum ladder accompanied by 44 warnings, about which an American Ladder Institute representative said that it takes Evelyn Wood training just to read the labels.²⁸) People have a "duty to inspect" the warnings—long or short, clear or cloudy.

A manufacturer, for example, can sell a lawnmower without a guard around the blade, and still escape liability when injury occurs. As long as the machine's booklet warns you, the product is not unreasonably dangerous. "Firms may potentially incur tort liability penalties for underwarning. Yet there are no penalties levied for overwarning."²⁹ Products liability law, which intends to protect people by creating incentives to produce safer products and by compensating them for injuries, is undermined by a rule of disclosure.³⁰

Disclosure displaces consumer protections in another important area—consumer credit. The pattern can be illustrated with an example of "loan flipping"—a practice that most of our readers have probably never encountered, but numerous less sophisticated Americans have. Loan flipping is the practice of repeated refinancing of a loan at the urging of an unscrupulous lender. It is bad for consumers because they incur repeated closing fees, they buy unnecessary "points," and often end up flipping a good low-interest or an unsecured loan with another that is secured by their home and that

27 Restatement (Second) of Torts §402A cmt. j. Recognizing that a warning "may either not be seen or will be disregarded," the Restatement (Third) of Torts seeks to reform this rule. RESTATEMENT (THIRD) OF TORTS: PRODUCTS LIABILITY § 2 cmt. l, reporter's note on cmt. l (2008). The Third Restatement, however, recognizes that "when an alternative design to avoid risk cannot reasonably be implemented, adequate instructions and warning will normally be sufficient to render the product reasonably safe."

28 Steven Waldman, *Do Warning Labels Work?*, Newsweek, July 18, 1988, at 40.

29 W. Kip Viscusi, *Individual Rationality, Hazard Warnings, and the Foundations of Tort Law*, 48 Rutgers L. Rev. 625, 628 (1996)

30 Howard Latin, "Good" Warning, Bad Products, and Cognitive Limitations, 41 UCLA Law Review 1193, 1218 (1994).

costs them more to initiate and more to pay out. People that have substantial equity in their homes, for example, could be “skimmed”: as a result of repeated loan flipping they end up converting a small uncollectable loan into a larger one secured by their residence.

Verna Emery was a victim of garden variety loan flipping.³¹ Initially, she borrowed \$2000 from her bank, promising to pay back \$1300 finance charges over 3 years (36% interest). The loan was secured by her household items. A few months later, the bank prompted her to flip the loan. Here is an excerpt from the letter Verna received, signed by the branch manager:

Dear Verna:

I have extra spending money for you.

Does your car need a tune-up? Want to take a trip? Or, do you just want to pay off some of your bills? We can lend you money for whatever you need or want.

You're a good customer. To thank you for your business, I've set aside \$750.00 in your name . . . Just bring the coupon below into my office and if you qualify, we could write your check on the spot. Or, call ahead and I'll have the check waiting for you . . .

When Verna showed up at the branch with the coupon, the bank was indeed ready to lend her more money. But instead of a separate loan, Verna was prompted to refinance her old loan, and for additional cash advance of \$200 her interest charges increased by \$1200. How? Very simple: the bank gave Verna \$2400, of which \$2000 went to pay the prior loan, \$200 were used to cover new closing expenses, and the remaining \$200 amounted to the new cash Verna received—her benefit from the new loan. For this net benefit of \$200, Verna became obligated to pay additional \$1200 over the life of the loan beyond what she was obligated to pay under the old loan.

When Verna Emery brought a suit alleging fraud with respect to the second loan, it was demonstrated that the Bank complied with all the TILA disclosure mandates. At the closing, the Bank meticulously provided to Verna the full stack the standard disclosures about APR, total payments, finance charges, and fees. But Verna’s complaint to the court was that the bank did not tell her the simple fact that additional funds could be borrowed at a far less costly way than taking out a new loan. To no avail. The trial invoked the compliance with TILA and dismissed the suit.

This case had an uncharacteristic ending. Normally, when a lender complies with TILA, his failure to tell the borrower how bad the loan is or how better some alternatives are does not give rise to liability for fraud. What sets this case apart is the unconventional majority decision by Judge Richard Posner, holding that technical compliance with TILA cannot legitimize a deliberately fraudulent scheme. Posner

³¹ Verna Emery v. American General Finance, Inc. 71 F.3d 1343, 1347-48 (7th Cir. 1995).

explained that “working-class borrowers” like Verna do not understand the “computations necessary to determine the comparative cost” of loan flipping. They “do not read Truth in Lending Act disclosure terms intelligently,” and they are tricked into “overpaying disastrously for credit.” Posner admonished the Bank for the falsehoods contained in the letter:

She is no “Dear Verna” to them; she has not been selected to receive the letter because she is a good customer, but because she belongs to a class of probably gullible customers for credit; the purpose of offering her more money is not to thank her for her business but to rip her off; nothing has been “set aside” for her. “[W]e could write your check on the spot. Or, call ahead and I’ll have the check waiting for you.” Yes—along with a few forms to sign whereby for only \$1,200 payable over three years at an even higher monthly rate than your present loan (and than your present loan plus a separate loan for \$200, which we could have made you), you can have a meager \$200 now.

Posner thought that technical compliance with TILA disclosures cannot legitimize a fraudulent scheme: “So much for the Truth in Lending Act as a protection of Borrowers” he protested. “Suppose [Verna] were blind. Or retarded. Would anyone argue that shoving a Truth in Lending Act disclosure form in front of her face would be a defense to fraud?”

Well, yes, American consumer law would: that “shoving” is a defense against fraud. Indeed, the shielding effect of TILA is exactly what the dissenting judge relied on: “Defeating all of the potential arguments available to Emery is a simple and uncontroverted fact: [the Bank] fully complied with the disclosure requirements of both the federal Truth in Lending Act and the Illinois Consumer Installment Loan Act.”³² The dissenter reminded Judge Posner of the conventional understanding: “By enacting TILA, . . . Congress has provided all the protection it deems appropriate for borrowers, be they financially astute or ill-informed and gullible.” Hence, manipulative and unethical practices, which are accompanied by technically accurate disclosure documents, are not fraudulent. As a result, anti-fraud statutes enacted to protect consumers are evaded by the compliance with mandated disclosure.

Disclosure displaces not only Federal consumer anti-fraud laws, but also rules of contract law that relieve people from “unconscionable” terms. Professor Robert Hillman was one of the first to explain how.³³ He knew that to be exempted from a

³² Verna Emery v. American General Finance, Inc. 71 F.3d 1343, 1350 (7th Cir. 1995) (Coffey, J., dissenting)

³³ Robert A. Hillman, Online Boilerplate: Would Mandatory Web Site Disclosure of e-Standard Terms Backfire?, in Boilerplate: Foundations of Market Contracts 83-94 (O. Ben-Shahar, ed, 2006).

contract term, consumers must show not just that the term is unfair but also that it is “procedurally unconscionable” (reached through tainted bargaining). This is ordinarily done by showing that the term was “hidden” and thus part of the bargain that the consumer chose to enter. But if the consumer received a PROMINENT DISCLOSURE in ALLCAPS and initialed it or clicked acceptance of it, how can the disclosed term have surprised the consumer? And, no surprise—no relief. An empty formality saves the contract from unconscionability.

Professor Hillman was right. A year after his article a federal court held that a one-sided and unfair arbitration clause in a cell-phone contract was not procedurally unconscionable. Because the contract was disclosed to the consumer (in a mass of fine print within a “Welcome Kit”), and because the arbitration clause was prominent enough (it began with the ARBITRATION heading and was mentioned “early” in the long form), the consumer was not “surprised.” Other courts have reached similar conclusions.³⁴

In these examples, disclosure backfires because it reduces the discloser’s exposure to litigation alleging fraud, deception, and other sharp dealings. We saw a similar effect when disclosure reduces the discloser’s exposure to products liability. Similar effects have been suggested in other areas. For example, mandated disclosure of an advisor’s conflicts of interests could limit the remedies that the advisee might otherwise recover for tainted advice. Or, some have suggested that disclosure by publicly traded firms of trades made by insiders managers *reduces* the likelihood of suits alleging securities fraud. By virtue of their disclosure, these trades become legal and hence do not make the insider trader liable.³⁵

Mandated disclosure can undermine another form of protection: consumers’ ways of protecting themselves by interpreting the situation in which they find themselves. Ordinarily, for example, voluntary disclosures can provide information beyond the disclosure’s express content. Voluntary disclosures can signal care, knowledge, experience, and even compassion. A doctor or a banker who will spend time volunteering information to a patient or customer seems trustworthy and dependable. Mandated disclosure, however, makes it hard to distinguish “revealers” (the good guys who volunteer information) from “concealers” (the bad guys who must be forced to do so).

Mandated disclosures can be confusing in another way. Even some proponents of the Miranda disclosure rule believe that it has been coopted by the police

34 *Rienche v. Cingular Wireless*, 2006 WL 3827477 (W.D. Wash.). See also *Williams v. First Gov’t Mortgage Investors*, 225 F.3d 738, 749 (D.C.Cir., 2000).

35 M. Todd Henderson, Alan D. Jagolinzer, and Karl A. Muller, *Strategic Disclosure of 10b5-1 Trading Plans* (mimeo. 2009) [OMRI: Is this really mimeographed?]

to lull suspects into the belief that the police who seem so concerned about their rights are actually on their side.³⁶ [More needed and available.]

Rather similarly, Lauren Willis says of mortgage borrowing that disclosures give transactions a “veneer of legality” and lull consumers into reducing their level of caution. A stack of official-looking legal documents gives the false sense that someone—the government—is on guard, reading terms and regulating transactions, so that consumers can be less cautious and careful.³⁷ The mass of disclosures can also suggest that a transaction is standard, the same treatment received by other, more sophisticated consumers.

Moreover, disclosure forms can mislead people into thinking that their transaction is complete when it is not. For example, loan applicants may see the disclosure ritual as the contract, rather than a precontractual aid. It is easy to confuse the signature confirming the receipt of a disclosure with the signature that closes a deal. Recognizing this confusion, TILA makes lenders disclose “in conspicuous type size and format” (but with what effect?) that “[y]ou are not required to complete this agreement merely because you have received these disclosures or signed a loan application.”³⁸

The irony is unsubtle: the only cure for the ills of disclosure is more disclosure. Here a second disclosure is mandated to keep disclosees from misunderstanding the first disclosure. Lawmakers must realize that people either don’t read or don’t understand the primary disclosure, or else people would not need to be assured that it is merely precontractual. But if people misunderstand a primary disclosure, why should they understand an ancillary one, telling them how to construe the primary one? In any event, this iterated disclosure example highlights lawmakers’ concern that financial disclosures might backfire in weakening people’s propensity to reject a deal.

This tendency of disclosures to soothe people into somnolence has been powerfully identified in the context of disclosures of conflicts of interests. In a fascinating experiment, Cain et al showed how such disclosures create the opposite effect from the one intended, of inducing people to exercise greater caution.³⁹ In the experiment, subjects had to guess the amount of money in a coin jar and were paid according to their accuracy. The subjects got suggestions from “advisers”—participants who had more time to examine the jars and make better estimates. The advisors had a conflict of interests: their payoff depended on how high their subjects’ estimates were, not how accurate. Some of these advisors had to disclose the conflict, others did not.

³⁶ [Citation to follow.]

³⁷ Lauren Willis, *Decision Making and the Limits of Disclosure: The Problem of Predatory Lending: Price*, 65 *Maryland L. Rev* 707, 794-95 (2006).

³⁸ Truth in Lending Act, 15 U.S.C § 1638(b)(2)(B).

³⁹ Daylian M. Cain et al, *The Dirt on Coming Clean: Perverse Effects of Disclosing Conflicts of Interest*, 34 *Journal of Legal Studies* 1, 22 (2005).

Standard wisdom suggests that disclosure of a conflict of interests would put subjects on guard, would teach them to trust the advice less and to suspect that the advisors' suggestions are inflated. Also, standard wisdom predicts that having disclosed their conflict, advisors would make more moderate suggestions and restrain their conflicting interest. But no: Disclosure led to greater distortion. Advisors who had to disclose their conflict of interests exaggerated more, and gave more biased advice than when disclosure was not required. And subjects receiving disclosure did not discount the advice enough to offset the bias. Subjects' guesses were less accurate with disclosure than without it. In the experiment, when conflicts of interests were disclosed, subjects made worse guesses and earned less money than when they were not.

These disclosures of conflicts of interests backfired for several reasons. On the recipients' side, disclosures can create what we've called a "soothing" effect, causing them to put more rather than less weight on the advice. As Cain et al explain it, "if a doctor tells a patient that her research is funded by the manufacturer of the medication that she is prescribing, the patient might then think that the doctor is going out of her way to be open and that she is 'deeply involved' and thus knowledgeable." In addition, in a follow up experiment it was shown that the conflicts disclosure creates a pressure on subjects to comply. Turning down the advice would signal distrust and a belief that the advisor succumbed to bias.⁴⁰ On the disclosers' side, there is the "yelling louder" effect (as Cain et al. call it): advisors might try to counteract the diminished weight of their advice by strategic exaggeration. Or disclosers may feel less guilty about giving biased and misleading advice. Any moral restraint, any intrinsic concern for the well-being of their subjects, that might otherwise inhibit the advisor conflict of interests, may be undermined and weakened by disclosures.

Common to all these examples, and the reason why disclosures sometimes destroy other protections, is the misguided premise that the disclosure paradigm is effective. This is why people ease their self-protection instinct, trusting that the disclosure must be setting things straight. And this is why courts remain skeptic towards consumers' claims of fraud, or else those courts would have to hold that the disclosures and warning are worthless (as Judge Posner—an outlier—did in the Emery case).

Precluding Better Regulations

Lawmakers beset by trouble stories typically have a tool chest of possible policies. For example, a lawmaker wishing to protect Verna Emery could prohibit or restrict specific practices, make lenders liable in tort, authorize regulators to enjoin deceptive behavior or to revoke lending licenses, punish misconduct through civil or criminal penalties, license lenders, mandate disclosures, and much more. Despite this

⁴⁰ Sunita Sah, George Lowenstein, and Daylian Cain, *The Burden of Disclosure* (Unpublished manuscript, 2010).

array of regulatory tools, it is rare for a single one to do the job, even combinations often work inadequately, and it is normally hard to tell what will be optimal.

Unfortunately, lawmakers typically get few genuine chances to act. Regulatory methods with bite normally encounter intense political resistance that prevents the lawmaker from adopting them, that allows them to be adopted only in weakened form, and that hampers their implementation. When regulation requires budgetary expenditures, all these problems balloon. So lawmakers must take advantage of the moments when there is pressure to act, political agreement can be reached, and funds are available.

Mandated disclosure, however, virtually invites lawmakers to spare themselves this often unrewarding labor. Mandated disclosure is routinely the easiest regulatory response to trouble stories. We discussed in Chapter 4 why it appeals to all ideologies. Consumer groups have long been committed to disclosure, perhaps partly because their leaders are also the people likeliest to use disclosures and because disclosure is now part of the consumerist ethos. Even business groups and merchant lobbies may support disclosures. And why not? What less disruptive way to yield to the inevitability of some kind of regulation and to calm roiled waters? Mandated disclosure delivers the political “mission accomplished” moment, but in so doing it drives out—for good or for bad—other regulatory techniques.

For example, as we said in the preceding section, mandated disclosure has the potential to undermine other consumer anti-fraud protections. Professor Hillman was one of the first scholars to notice this effect. His distinction as a leading contracts scholar and his insights about online contracting earned him the position of Reporter for the influential American Law Institute’s “Principles of the Law of Software Contracts,” which drafted new principles and solutions to a growing area of practice. We already mentioned earlier in the book the ambitious agenda that this ALI project initially had, and the ironic fact that in the end the main new solution emerging from the Principles was disclosure. The Principles’ “preferred strategy” is “to promote reading of terms” before contracting and “to increase the opportunity to read.” In contrast to existing law, terms not pre-disclosed would no longer be binding. Better disclosures and better opportunities to read are supposed to “increase the number of readers of standard forms” and make assent more “meaningful” and more “robust.”⁴¹

To those not fluent in the technicalities of contract law, a quick explanation is owed. The ALI Principles’ disclosure rule is a response and an attempt to reverse judge-made law. In 1996, Judge Frank Easterbrook of the Seventh Circuit Court of Appeal held—and many courts later followed—that consumers are bound to fine print contract term even if the forms containing terms came sealed (“shrinkwrapped”) in the box and

41 ALI principles, at 130-131.

could only be read after the purchase is completed.⁴² Consumers who do not want to be bound to the fine print would have the right to return the product. Notwithstanding the fact that Easterbrook's decision gave consumers something that American contract law never before guaranteed—a sweeping right to withdraw from contracts after the purchase, if they don't like the terms—many consumer advocates resented this rule. People should have an opportunity to read the fine print before they purchase, advocates thought. Thus ensued fifteen years of effort to draft and enact laws for contracts in the internet era. One can wonder whether this reform truly benefits consumers—taking away the right to withdraw from a contract and giving instead another disclosure of fine-print. But the striking lesson is that even sophisticated lawmakers who recognize the risk of disclosure backfiring are swept by the political dynamics: disclosure earns consensus.

Professor Hillman is not alone in pointing out ways in which mandated disclosure undermines other consumer protections. For example, in 2000, long before the consumer-mortgage crisis, the Departments of Treasury and of Housing and Urban Development issued a report recommending ways to curb predatory lending. The report recognized that “written disclosure requirements, without other protections, can have the unintended effect of insulating predatory lenders where fraud or deception may have occurred.”⁴³ That is, they recognized the undermining effect: there are tools to go after lenders who commit fraud and deception, but not after those who also make conspicuous disclosures.

As we write this book, we don't know yet which regulatory techniques will eventually be adopted by the new Consumer Financial Protection Bureau to protect consumers like Verna Emery from predatory lending. Will regulators institute new prohibitions against deceptive marketing of credit? Harsher sanctions? Limits on loan flipping and on other fees? License revocations? Will they outright forbid types of risky loans that proliferated at the sub-prime market? Past experience suggests that many ambitious reforms will be considered, but that when all will be said and done, a new round of “improved” disclosure will feature prominently. Secretary of the Treasury Timothy Geithner's announcement that the new Bureau would “dramatically” improve disclosures is perfectly consistent with this trajectory. His subordinates have already warned that “merely simplifying disclosure to those consumers unlikely or unable to shop for a loan (i.e., those borrowers who are older, infirm, less informed, or who, in fact, have fewer credit options available to them) cannot be expected to protect them from abuse.” But Geithner continues to believe that disclosure “is one of the most powerful tools we have for getting people better information so they can make better choices about how they borrow, how they use credit, how they invest their savings.”

⁴² ProCD v. Zeidenberg, 86 F.3d 1447 (7th Cir. 1996).

⁴³ U.S. Dep't of Hous. & Urb. Dev. & U.S. Dep't of Treasury, Recommendation to Curb Predatory Home Mortgage Lending 67 (2000).

C. MAKING DECISIONS WORSE

Mandated disclosure's principal goal is to improve the quality of decisions people make. We have examined in Part II the reasons people have trouble understanding and using disclosures. We argued there that disclosures fail to produce the private and social benefits intended. But sometimes disclosures not only fail to make decisions better; they actually make them worse. This can happen in several ways.

The harmlessness hypothesis appears to rest on the more-information-is-better principle. But more information is not better if the added information is inaccurate; or if the information is misleadingly incomplete; or irrelevant to the decision to be made; or when it leads people to over-emphasize or under-emphasize factors in making decisions. Yet for reasons we have already explored, disclosers will often be hard pressed (and sometimes reluctant) to provide accurate, complete, or relevant information. To put the point somewhat differently, mandates succeed only when they cause people to be given the right information at the right time in the right quantity in the right way with the right emphasis. When one of these conditions is not met, disclosures may not only fail to improve decisions – they may actually make them worse.

For example, consider what we may call the “crowding out” effect. Because disclosers can proffer and people can receive only so much information, mandated disclosures keep people from acquiring other information. If learning the mandated information is what the recipient of the disclosure most wants and needs to do, this crowding out may not matter. But mandates are rarely so precise. Thus Richard Craswell points out that mandated disclosures may “reduce the attention consumers pay to other information, conceivably leading to worse decisions rather than better ones.” Craswell gives the example of brokerage fee disclosures that cause consumers to overestimate the total cost of the loan,⁴⁴ but the phenomenon is broader. It can be acute in many financial contexts, so let's consider one – pension-related investments.

After a generation of ERISA regulations and pension-protection legislation, participants in pension plans are awash in seas of disclosures with waves of data about defined-contribution plans, 401(k) enrollment, company-stock diversification, distributions, rights-to-defer, and much else. Most people never open a prospectus, hardly understand even the titles of the disclosures, and dismiss them in making choices. But disclosurites have recently written much about disclosing fees. People may

⁴⁴ Richard Craswell, Taking Information Seriously: Misrepresentation and Nondisclosure in Contract Law and Elsewhere, 92 Virginia L Rev 565, 584 (2006).

understand when told that a certain percentage of their pension investment is eaten up by fund managers' fees. However, an effective disclosure of fees can have the unintended "blinding" consequence of deterring employees from investing adequately. It is hard for people to evaluate the messy metric of expected risk and return. It is easier to evaluate the annual fee. The disclosure can thus cause people to overemphasize this one feature and therefore make poor choices.

But the reverse can also be true: disclosures can cause people overemphasize returns when fees are more significant. And this can be true even with exceptionally well-educated and sophisticated disclosees. For example, Choi et al used specially simplified forms to give such disclosees the only information they needed to choose among index funds – the costs of the funds. "Despite this unbundling, subjects overwhelmingly failed to minimize index fund fees. Instead, they placed heavy weight on irrelevant attributes such as funds' annualized returns since inception. . . . Even subjects who claimed to prioritize fees in their portfolio decision showed minimal sensitivity to the fee information in the prospectus. Subjects apparently do not understand that S&P 500 index funds are commodities."⁴⁵

These lessons are disheartening. Disclosures that manage to penetrate people's filters and influence their choices also create biases. When choices are immanently multi-factored and complex, and when the filter-penetrating disclosure must be inherently simple, we have a mismatch. Illuminating narrow slices leaves the rest of the landscape darker.

Micheal Pollan has argued that mandates to disclose nutrition data similarly misfire: by telling consumers only about some aspects of the food but not others, they exacerbate obsessions and eating disorders that focus on narrow, rather than balanced, intake. One of Pollan's examples is campaigns for low-fat foods.⁴⁶ As food packaging and marketing highlighted fat and focused attention on low-fat products, Americans switched away from high-fat food. But this tendency coincided (to general surprise) with a rocketing increase in obesity and diabetes. Apparently people ate more carbs, or simply ate more food. The salience of one ingredient may have distorted the big picture.

In many situations, disclosures try to be relatively comprehensive and give disclosees access to reasonably complete information, and yet we see that people are drawn to overemphasize one set of factors. However, sometimes disclosure mandates reduce the likelihood that nonmandated information will be provided at all.

⁴⁵ James J. Choi et al, Why Does the Law of One Price Fail? An Experiment on Index Mutual Funds, on-line at <http://www.som.yale.edu/faculty/jjc83/fees.pdf> 1, 28 (last visited February 22, 2011). Cost was the only relevant consideration because the funds matched their indices accurately, so that the funds were essentially commodities.

⁴⁶ Michael Pollan, In Defense of Food 58-59 (2008).

Sometimes, for example, marginally useful medical mandates drive out necessary but unmandated information. Guidelines prescribe more work for doctors to do with their patients than doctors could possibly have time for. This is all work that can improve patients' health, often considerably. However, over the years the disclosure mandates have accumulated mightily. Providers must tell patients about advance directives and living wills, about privacy policies, about standard risks and the benefits associated with different treatment choices (through informed consent forms), about side effects, safety, cost, conflicts of interests, sometimes even insurance implications. After all this information has been disclosed, how much is left in the patients' reservoir (and the providers') to learn about things that are life- and health-saving, like how to manage a chronic illness? Or to persuade patients to follow their treatment regime? Compliance rates are usually said to be around 50%. Patients must be patiently taught and persistently prompted to get medicine, ingest it properly, take the right dose at the right time, and not to stop too soon. Such strenuous but essential teaching is crowded out by disclosures mechanically mandated and mechanically supplied.

The problem with misinformation is not only that people's attention to inputs becomes biased. It is also that in many areas in which disclosures are mandated, more information and better understanding of information are needed than many people realize. Yet people who have read disclosures are too likely to be convinced that the disclosure contains all they need to know and that they have understood what they have read. If they have not, their misplaced confidence will sometimes lead them astray.

One study, for example, evaluated the effect of financial education on retirement savings decisions. In the experiment, university staff members (with college education) were given three to five hours of financial training in one-on-one or small-group settings, tailored to help them make their own retirement planning. Their skills were tested before and after the seminar, as well as the quality of their retirement savings decisions. The study did pick up a modest improvement in the participants' ability to consider information and to perform financial tasks, especially among those classified at the outset as "low knowledge." But the study also showed the improved skills did not translate into improvements in decisions. In fact, after the training the subjects made errors that would have led to depletion of all their assets and income long before the ends of their predicted life spans. The most troubling aspect—and where the harmlessness hypothesis is refuted—was the fact that subjects believed that the quality of their decisions *did* improve as a result of the training, even though it did not. The authors conclude that "commercial financial training may do more harm than good—individuals may feel confident that the quality of their financial planning efforts are sound, despite clear objective evidence to the contrary."⁴⁷ If this experimental effect

⁴⁷ Douglas A. Hershey et al., Challenges of Training Pre-Retirees to Make Sound Financial Planning Decisions, 24 Educational Gerontology 447, 468 (1998).

is robust—if people equipped with disclosures exhibit overconfidence—they might be harmed by trusting their own decision and failing to seek guidance.

D. MAKING MARKETS WORSE

One of the unequivocal advantages of mandated disclosure is supposed to be that – whatever else it may or may not do – it improves markets by improving the information purchasers have about their choices. However, sometimes mandated disclosure actually damages markets. We can illustrate several ways in which market functions are damaged.

Quality Distortions

Not all quality dimensions relevant to a decision can be disclosed. We already pointed out the concern that people will overemphasize the disclosed dimensions and neglect to think about other important dimensions. This bias in favor of disclosed dimensions is not just a cognitive error. It is also a consequence of disclosers' incentives. Rational disclosers will invest disproportionately in the quality dimensions that are more likely to be disclosed and ascertained by their clients.

A smart writer once lamented “the folly of rewarding for A while hoping for B.”⁴⁸ Analogously, we lament the folly of requiring disclosure of A while people also care about B. This is the same problem education policy discovered when instituting standardized tests that measure performance along some, but not all, parameters: schools end up teaching to the test. People can disagree on whether education policy can do better, but few doubt the robustness of the teaching-to-the-test phenomenon. In disclosure policy, the analogous problem is the incentive for disclosers to reallocate their resources and focus more intensely on reported dimensions, at the expense of unreported ones.

A study of nursing-home-quality disclosures provides an empirical confirmation of this effect. In 2002, the Center for Medicare and Medicaid Services launched the Nursing Home Quality Initiative, which replaced an older and ineffective disclosure regime that covered more than 190 quality dimensions. The new, simplified “report card” policy began with only 10 quality dimensions and grew to 15 (a reported dimension could be something like “percent of residents with pressure sores”). There was encouraging evidence that nursing home clients were consulting these report cards when making choices. And there were some improvements in the quality of the reported dimensions. But, the total number of deficiency citations from random inspections—the metric used in the study to measure overall quality of a nursing

48 Steven Kerr, On the Folly of Rewarding A, While Hoping for B, 18 *Academy of Management Journal* 769 (1975).

home—grew. In other words, there were less violations in the reported dimensions, but more violations in the unreported dimensions, with the downside more than offsetting the upside. Nursing homes, apparently, changed the mix of their inputs, investing more emphasis on reported quality and cutting back on the unreported aspects.⁴⁹

There is, however, an optimistic wrinkle that emerges from this insight, which we plan to develop in the next chapter. When disclosures report an overall measure of customer satisfaction, rather than a list of quality dimensions, there is no potential for a “teaching to the test” effect. Such consumer satisfaction aggregate ratings are also more useful to people and are more often relied on than the mandated disclosures of numerous quality measures. This is true for a variety of market transactions, from the purchase of a \$10 flash drive on eBay to the choice of health plan. Indeed, a recent study of 40 million Medicare enrollees showed a substantial shift by patients towards enrollment health plans that had better report cards. The study showed that enrollees did not respond to reports of basic quality dimensions, but rather their choices were driven by the disclosures of consumer satisfaction ratings.⁵⁰

Anticompetitive Effect

Complying with mandated disclosure can involve both fixed and variable costs. Fixed costs do not vary with the scope of activity or the frequency of disclosures. These costs—collecting information, drafting forms, training employees—are roughly the same for large and small disclosers. Variable costs increase with the scope of activity. For example, the cost of printing disclosure forms, reciting oral disclosures, and customizing disclosures to particular clients are variable costs.

When the fixed-costs of disclosures are significant, large entities have a competitive advantage over smaller ones. Their disclosure burden per “unit” is smaller because they can spread the cost more broadly. This hurts small companies trying to enter and compete in the market. Frank Easterbrook and Daniel Fischel recognized this effect a generation ago while examining mandated disclosure in securities markets. They argued that the elaborate disclosure rules of securities laws “give larger issuers an edge, because many of the costs of disclosure are the same regardless of the size of the firm or the offering. Thus larger or older firms face lower flotation costs per dollar than do smaller firms.”⁵¹ In such circumstances, rivals may find it hard to compete effectively against large, entrenched firms.

49 Susan Feng Lu, *Multitasking, Information Disclosures and Product Quality Evidence from Nursing Homes* (Simon School working paper No. FR 09-03, Univ. of Rochester 2009).

⁵⁰ Leemore Dafny and David Dranove, *Do Report Cards Tell Consumers Anything They Don't Already Know? The Case of Medicare HMOs*, 39 *RAND J. Econ* 790 (2008).

⁵¹ This argument was made in the context of securities regulation by Frank H. Easterbrook & Daniel R. Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 *Virginia L Rev* 669 671 (1984)

Such anti-competitive effects could result, for example, from disclosure mandates imposed on vocational schools. In some states, they must address as many as twenty topics, including graduation rates, re-enrollments, exam pass rates, graduates' job prospects, and much more.⁵² Collecting this information requires investments in bureaucracy and record-keeping small schools can ill afford. It also requires internal monitoring of standardization, another fixed cost that burdens smaller competitors. Similarly, an anticompetitive effect could result from calorie-labeling mandates imposed on restaurants under the recent health care reform bill. This is why the mandate applies only to restaurant chains of 20 or more outlets.⁵³

Even when disclosers are not directly competing, mandates may favor large, well-funded, and sophisticated enterprises and discourage small, ill-funded, and unsophisticated ones. For example, as the IRB system that regulates disclosures of information to prospective research subjects as become more demanding, it is becoming harder to conduct many kinds of research unless you have the resources and expertise to deal with the regulators. The evidence from multi-site medical research is that researchers can spend more than 15% of their budget just dealing with IRBs (whose principal work is supervising disclosures). Well-funded researchers can afford to pay people just to handle negotiations about disclosures; poorly funded researchers cannot. Long-term projects can afford to take many months getting agreement on disclosures; short-term projects can spend so much time getting that agreement that they do not have time to complete the research.

Consumer Opportunism

We argued that mandated disclosure is too weak to remedy the behavior of unscrupulous lenders. The flip side is also true: mandated disclosure could be too powerful and could allow remedies to undeserving, opportunistic borrowers.

For example, John Dalton and Arnold Lowery both purchased Pontiacs from Bob Neill Pontiac in North Carolina, and financed the cars through the dealer. In each case, the cash price included \$4 for license and title fees, which the dealer retained and passed on to the Department of Motor Vehicles.⁵⁴ Mistakenly, the dealer did not itemize these charges individually on the disclosure statements. Dalton and Lowery each sued

52 Private Business and Vocational Schools Act, 105 ILCS 425/15.1 (Illinois disclosure statute applying to enrollment in vocations schools); Barber, Cosmetology, Esthetics, and Nail Technology Act, 225 ILCS 410/3B-12(a) (Illinois, 1985) (numerous disclosures required in school enrollment agreements); Cal. Veh. Code. § 11200(1) (2007) (disclosure by traffic violator schools); NJSA 13:23-5.16 (disclosure by driving schools).

53 Sec 2572 Nutrition Labeling Of Standard Menu Items At Chain Restaurants And Of Articles Of Food Sold From Vending Machines.

⁵⁴ Dalton v. Bob Neill Pontiac, 476 F.Supp 789 (1979).

to recover \$2000 statutory damages available under TILA, for that failure to disclose the itemized fees. The court was openly upset about the frivolous nature of the complaints. It reminded the consumers that the purpose of TILA is to inform consumers, not to punish creditor who caused no harm and acted in good faith. “The Act becomes tarnished when it is used to reach a flagrantly inequitable result. These case . . . are excellent examples of how the Act can be abused.” The court thought that “many of the truth in lending case . . . have not been brought by plaintiffs who were misled or misinformed by the loan forms they attack. These plaintiffs have merely sought a windfall penalty from a lender by picking apart its loan form word by word in search of a technical deviation from the language of the statutes and regulations.” As a result, TILA “seems to serve mostly as a trap for the unwary creditor, increasing the cost of credit extensions and eliminating the small credit extender from the market.” The court complained that “such Robin Hood justice is repulsive” but nevertheless obeyed the language of the law and entered a judgment for the consumers.

In Dalton and Lowery’s cases, TILA was used to go after the creditor. Lowery, in fact, was an habitual claimant, who succeeded in suing at least two other creditors for TILA violations. But most consumers are not hunting down their creditors. Rather, they invoke disclosure violations as a defense against creditors’ collection actions. The pattern is this: a consumer takes a loan and then fails to make payments. The creditor files a collection suit. The consumer’s lawyer digs deep into the closing document, at which point it is again almost inevitable that due to the complexity of TILA and other disclosure acts a violation will be found. Since violations are easy to prove (there is little factual dispute) and since they give rise to automatic statutory damages and recovery of attorney’s fees, the creditor can no longer recover the debt and might even have to pay some redress to the consumer. As one seasoned lawyer working on the lender side testified, he spent most of his career “drafting disclosures that I feel are never read by consumers and, in truth, do very little to educate consumers about the cost of credit. From my perspective, the people that read the disclosures I help develop are plaintiff’s attorneys.”⁵⁵

One commentator called this scenario the “Disclosure Defense Game.”⁵⁶ Such disclosure defenses have nothing to do with any harm suffered by consumers, any dissatisfaction with the loan or the product, or any complaint regarding the integrity of the creditors. Like in Dalton and Lowery’s case, the defense almost never invokes the spirit of the disclosure paradigm—namely, that the consumer was denied valuable and critical information and thus made a bad decision. It is enough to find a technical violation to trigger the strict liability and statutory damages, thereby to fend off the creditor’s collection action.

⁵⁵ Re-Examining Truth in Lending: Do Borrowers Actually Use Consumer Disclosures? 52 Consumer Fin. L. Q. Rep. 3 (1998)

⁵⁶ Mark Petit, Jr., Representing Consumer Defendants in Debt Collection Actions: The Disclosure Defense Game, 59 Texas L. Rev. 255 (1981).

Lawmakers are aware of this problem. A few years after the original enactment of TILA, Congress returned to the drawing board and produced a new version of the statute— the Truth In Lending Simplification and Reform Act (TILSRA) of 1980. Congress intended to make compliance with TILA easier for creditors and preempt the frivolous disclosure defenses. Indeed, many technical requirements were simplified and eliminated, reducing the opportunity to invoke disclosure defenses. But the basic problem did not go away. Over time, the “simplified” TILA grew more complex yet again, further bolstered by an amalgamation of state statutes relating to consumer credit. Disclosure defenses did not go away because, even in TILSRA, the statute explicitly says that it “does not bar a consumer . . . from asserting a violation of this title as an original action, or as a defense or counterclaim to an action to collect amounts owed by the consumer.”⁵⁷ In fact, the law facilitates such disclosure defenses by extending the statute of limitations. Whereas consumers are usually given one year from the date of the disclosure to sue for TILA violation, the reform allowed them to assert a violation long after the one year expired, if the assertion is made in defense against a collection action.⁵⁸

The problem of disclosure defenses recently received publicity when sophisticated homebuyers used archaic disclosure laws to escape real estate contracts. The culprit here was the Interstate Land Sales Full Disclosure Act (ILSA)—a statute designed in the 1960’s to solve a problem of sham sales. At the time, the federal government responded to a problem of fraud and abuse in advertising interstate sales of homes. People were sold castles in the sky and lost their money. The ILSA required developers of subdivisions and condominiums to show buyers a “Property Report”— 20-30 pages of detailed information about the property. Over the years, trouble stories about deception subsided and then disappeared. Developers and their lawyers paid less and less attention to this law, and buyers have not noticed the missing Property Reports. Until recently, when developers who forgot to hand out these disclosures learned to regret their oversight. Under the law, failure to issue the Property Report allows buyers to renounce their otherwise legally binding agreements, however unjustified that renunciation and however harmful to developers who sold in good faith. Buyers of high-end condos in New York City and Florida, who signed contracts free of sham or deception at market prices, were chagrined when the market collapsed in 2008. These buyers became the only remaining beneficiaries of the legislative carcass. They are now using the excuse that disclosures were incomplete to cynically evade their commitments and rescind their contracts. “We had to find some law to help these people, and that’s what ILSA did,” says a lawyer for one of these consumers.

⁵⁷ Truth In Lending Act §130(h), 15 U.S.C §1640(h).

⁵⁸ Truth In Lending Act §130(e), 15 U.S.C §1640(e).

These patterns are unfair to creditors, but they are also bad for markets. Opportunistic disclosure defenses fail to discriminate between good and bad creditors, or between meritorious and frivolous consumer complaints. They place a burden—a penalty, a “tax”—on creditors and raise the cost of credit to all. They waste litigation resources by “transforming loan documents into contest puzzles in which prizes are awarded to those who can uncover technical defects.”⁵⁹ And, ironically, they can reduce the incentives of disclosers to institute helpful informative practices, fearing that any ritual other than the technical mandate could be held a violation.

E. MAKING SOCIETY WORSE

*"Autre motif d'orgueil, que d'être citoyen! Cela consiste pour les pauvres à soutenir et à conserver les riches dans leur puissance et leur oisiveté. Ils y doivent travailler devant la majestueuse égalité des lois, qui interdit au riche comme au pauvre de coucher sous les ponts, de mendier dans les rues et de voler du pain."*⁶⁰

Anatole France, The Red Lyly

In this section, we suggest that mandated disclosure misallocates scarce social resources. Mandated disclosure intends to improve people's decisions by improving people's knowledge. Yet it helps least those who need help most and helps most those who need help least.

Helping the Rich

The poor and poorly educated are those most likely to be at an information disadvantage. (We use “poor” and “wealthy” and “poorly educated” and “well educated” as shorthand for people's relative positions on the continuum between true poverty and great wealth and the continuum between no education and several terminal degrees.) The poor and poorly educated are most likely to be at this disadvantage because they are vulnerable in so many relevant ways. They have more troubles and fewer resources. Mandated disclosure is intended to help people make better decisions, but the poor and poorly educated begin with a crucial disadvantage in making most decisions—they have less money and thus fewer and worse choices. The travails of the poor in their capacity as consumers, patients, victims, human subjects, or workers, are graver than those of the elite. They have harder decisions and, living on the economic precipice, more to lose from bad ones. They pay higher interest than people

⁵⁹ Wilson v. Allied Loans, Inc., 448 F.Supp. 1020, 1022-23 (1978).

⁶⁰ **Error! Main Document Only.** Another reason for pride, that of being a citizen! For the poor citizenship consists of supporting and sustaining the power and idleness of the rich. They must work for those goals before the majestic equality of the laws, which forbids rich and poor alike to sleep under bridges, to beg in the streets and to steal bread.

better situated to make the payments, they deal with less reputable lenders and vendors but, lacking other resources, must rely on them more. They can only afford inferior and riskier products. They have worse health plans, more risk, and less insurance. They rarely consult professionals, much less really able ones.

The poor and poorly educated, then, are exactly the people the regulatory method of mandated disclosure seems most intended to help. For the reasons we have just suggested and more, they are vulnerable to people who have information they lack. However, the reasons they lack that information also apply to their ability to use the information mandated disclosure seeks to provide them. They lack information because they cannot read or understand numbers well. But readings and numbers are just what mandated disclosure supplies. They misunderstand information because they lack the baseline understanding of problems necessary to interpret it. But that baseline understanding is also necessary to interpret the information mandated disclosure would give them.

So even though the poor and poorly educated are need more help in dealing with stronger parties, the help they get from mandated disclosure is the kind least likely to benefit them. This is not only logical, it is supported by empirical evidence. Poor consumers are less influenced by “persuasion” and “behavior modification” disclosure campaigns. For example, low-income parents are more “fatalistic” about children’s exposure to hazards and less influenced by safety warnings, even though the children are disproportionately exposed to these hazards.⁶¹

The poor and poorly educated benefit less than the wealthy and better educated from other kinds of disclosures. The benefits of financial education accrue more often to the better off. Older and higher income shoppers are more likely to access online disclosures of terms, because they find it easier and less costly to read contract terms.⁶² Information disclosed in the sale of used cars—the car’s safety and repair history, odometer readings, and warranties—seem not to help the poor, who continue to pay more for worse quality cars. Mandated disclosure may have even worsened the relative situation of the poor.⁶³ The same has been shown for nutrition data, hospital report cards, informed consent forms, vaccinations, preventive dental care, gun handling, and seatbelts. In fact, these are all illustrations of a more general phenomenon, pointed out long ago by George Stigler: Low-income people often benefit less from public expenditures and programs. Stigler argued, for example, that public provision of higher education benefits the middle and higher income people and redistributes income away

⁶¹ Klein, Social Influences on Chiled Accidents, 12 Accident Analysis & Prevention 275 (1980).

⁶² Yannis Bakos et al, Does Anyone Read the Fine Print?: Testing a Law and Economics Approach to Standard Consent Form Contracts, NYU Law & Economics Research Paper Series 4, Working Paper No. 09-40, <http://ssrn.com/abstract=1443256>

⁶³ Kenneth McNeil et al, Market Discrimination Against the Poor and the Impact of Consumer Disclosure Laws: The Used Car Industry, 13 Law & Society Rev. 695, 699 (1979).

from the poor. He showed that the distribution of income of parents of students in higher education is skewed towards large incomes, a benefit that is paid for by all, through higher taxes.⁶⁴

Further evidence about the disproportionate hurdles faced by weaker recipients come from medical disclosures. Medical consent forms are so notoriously long, complex, and obscure “that the average person in the United States is likely to find them difficult to read.” For example, Sharp found that consent forms for oncology trials ranged from four to twenty-six pages with a mean written at “a college level of reading difficulty.”⁶⁵ The problem is not that individual doctors and researchers write bad consent forms. The problem is built into the system, is part of institutional practice, and is exacerbated by regulators themselves. For example, a study of the ten best resources for learning about prostate cancer—which were presumably developed by people skilled at imparting this kind of information—found that even though they did not give patients enough information to help them making decisions, all but one were written at a level beyond the reading capacity of the average adult.⁶⁶ Another study looked at institutional behavior. It examined “templates of HIPAA authorization forms for research” from elite medical centers. Nearly all of them had inappropriately complex language on all 3 readability scales.” Their language “was similar in complexity to that in corporate annual reports, legal contracts, and the professional medical literature.”⁶⁷ Furthermore, regulatory supervision has made disclosures *less* readable. Thus one study of research consent forms found that IRB review made the forms longer, the sentences longer, the active voice scarcer, and the difficulty level higher so that 41% of the forms “had an inappropriately high reading grade level.”⁶⁸

The better-off and better-educated are not at the kinds of disadvantages we just attributed to the poor. Their choices are better and more numerous, their needs are less urgent; it is easier for them to reject a transaction or decline to make a choice when information looks troubling. They know better how to search for information, can better understand the information they receive, can better ask acute questions about it,

⁶⁴ George J. Stigler, Director’s Law of Public Income Distribution, 13 J. L. & Econ. 1 (1970).

⁶⁵ S. Michael Sharp, Consent Documents for Oncology Trials: Does Anybody Read These Things?, 27 American Journal of Clinical Oncology 570, 570 (2004) (doi: 10.1097/01.coc.0000135925.83221.b3).

⁶⁶ Angela Fagerlin et al, Patient Education Materials About the Treatment of Early-Stage Prostate Cancer: A Critical Review, 140 Annals of Internal Medicine 721 (2004).

⁶⁷ Stuart A. Grossman et al, Are Informed Consent Forms That Describe Clinical Oncology Research Protocols Readable by Most Patients and Their Families?, 12 Journal of Clinical Oncology 2211, 2212 (1994).

⁶⁸ William Burman et al, The Effects of Local Review on Informed Consent Documents From a Multicenter Clinical Trials Consortium, 24 Controlled Clinical Trials 245 (2003) (doi: 10.1016/0197-2456(03)00003-5).

can better comparison-shop, and (not least) can get better counseling.⁶⁹ They are likelier to have baseline information with which to interpret information. If anybody can use mandated disclosures, it is likely to be they.

Not only does mandated disclosure help least those who need help most and help most those who need help most, the choice of what disclosures to mandate appears to be shaped by upper middle class concerns about risk, health, privacy, finances, environment, and accountability. Many “educational” disclosures—retirement savings, internet privacy, health-plan choice, mandatory arbitration in consumer contracts, college choice, and nutritional balance, to name a sample—correspond better to middle class and elite concerns.

In short, although mandated disclosure masquerades as a democratic vehicle to “empower” the unprivileged, it actually benefits the privileged more than the unprivileged. Disclosures are nuts distributed to all, but only those with teeth can bite. The poster cases for mandated disclosure, the people whose hardships and trouble stories sparked the political process that gave rise to the disclosure mandates, are least the beneficiaries.

Taking From The Poor

We have suggested that mandated disclosure is often inequitable because it puts resources where they are least need them and denies them where they are most needed. But mandated disclosure can cause another, more disturbing inequity. If the prosperous disproportionately benefit from disclosures, they should disproportionately pay for them, or at least contribute a pro rata share. However, the burdens of disclosure are often borne disproportionately by the less educated poor—those least likely to enjoy them. Disclosures, in other words, create a regressive wealth transfer, in which the masses subsidize the classes.

For example, hospital report cards appear to have made things better for the rich and worse for the poor. Hospitals must publicize “performance scores,” aggregating various measures of the quality of treatment they provide, most often mortality rates. The rationale for these disclosures is pleasingly plausible: even if patients rarely read the evaluations, insurers or regulators might, and thus providers might strive for good scores. There is evidence that hospitals indeed aspire to improve their report cards.⁷⁰

The empirical lessons about the overall success of this regime are still uncertain and point in many different directions. There are some encouraging indications that

69 Barbara O’Neill et al., Money 2000 Participants: Who Are They?, 37 J. Extension 6 (1999); Kimberly Gartner and Richard M. Todd, Effectiveness of Online “Early Intervention” Financial Education for Credit Cardholders (July 2005).

70 David Dranove, Code Red

care in reported dimensions improves. Some of this is because health-plan administrators and insurers read the disclosures and channel people to better care. But some of this is because patients (especially the more sophisticated ones) shift to the better hospitals. And there is some evidence that hospitals try to protect their ratings by shifting their efforts from unreported dimensions of care toward reported dimensions.⁷¹

However, the most discouraging finding is that report cards created a “musical chairs” dynamic. Healthier patients found their way to higher rated hospitals, while sicker patients were treated in hospitals with worse grades. David Dranove’s group showed that report cards led to “marginal health benefits for healthy patients, and major adverse health consequences for sicker patients.” Overall, people are worse off.⁷² Perhaps this is due to the enhanced ability of more sophisticated patients to enter higher quality hospitals, thereby leaving less space or bumping out the less sophisticated and sicker patients. This is consistent with findings that show that generally patients have difficulty understanding report cards, but also show that report cards for organ transplantation improved outcomes for younger and more educated patients. Or, perhaps the musical chairs are due to providers’ incentive to protect their scores, dodging severely ill patients. Either way, the disclosure that helps the better-off also hurts the worse-off.

To take another example, credit-card involve a cross subsidy even leaving mandated disclosures aside. The chain of events is familiar: wealthier users get free cards and frequent flyer miles while paying almost no fees and lower interest. Poorer users, in contrast, carry higher balances, pay more interest, finance charges and other fees, and get few perks. All enroll in the same service with largely the same terms, but one group bears more of the downside while other enjoys more of the upside. This is an implicit cross-subsidy: in a unified pool of customers, the payments collected from the poor fund the wealthy’s perks.

Disclosures, which are intended to help the impecunious, only exacerbate the cross-subsidy. Better educated and wealthier users read, understand, and exploit the information in the Schumer boxes or the disclosures attached to their monthly statements. The more disclosure-trained and cautious they learn to be, the more disproportionate the burden borne by the weak, who are less likely to be effectively influenced by the disclosure.

Another, subtle context in which sophisticated users benefit from a cross-subsidy is contract boilerplate. Disclosed terms give them additional value, for which all

71 Susan Feng Lu, Multitasking, Information Disclosures and Product Quality Evidence from Nursing Homes (Simon School working paper No. FR 09-03, Univ. of Rochester 2009).

72 David Dranove et al, Is More Information Better? The Effects of ‘Report Cards’ on Health Care Providers, 111 J. Pol. Econ. 555 (2003). In later research, Dranove found more encouraging overall effect on quality of care. See [medicare study].

consumers pay. Thus, in a recent “Contract Agreement for Residential Service,” Comcast included a mandatory arbitration provision and disclosure:

“Right to Opt Out : If you do not wish to be bound by this arbitration provision, you must notify Comcast in writing within 30 days of the date that you first receive this agreement by visiting www.comcast.com/arbitrationoptout, or by mail.”⁷³

People who opt out of mandatory arbitration can bring suits and perhaps class actions, something only the sophisticated could know. This means a higher likelihood of suit, greater liability for the firm, and higher settlements. These benefits to opt-outers do not trickle through to the clients who do not sign up for the opt-out. But the heightened litigation risk is costly to vendors like Comcast (which is why they try to reduce the risk with arbitration clauses.) When some customers opt out, Comcast must add the cost of exposure to its service charges. However, Comcast does not charge the opt-outers more, but rather spreads the cost across all its customers. To be precise, it is not the disclosure per se that creates the cross subsidy, but rather the option to sign up for a more costly clause. But against the natural instinct of vendors to blur such clauses, the mandated disclosure movement guarantees consumers the right to know—the right to receive prominent reminders concerning the presence of mandatory arbitration and how to opt out. This added prominence aggravates the cross subsidy enjoyed by the sophisticated few.

F. AT WORST, LETHAL

We began this chapter by recognizing the harmlessness hypothesis—the belief that disclosure is “inexpensive and, at worst, harmless”—noting that it explains the mystery of mandated disclosure’s persistence despite failure. In earlier chapters we suggested that mandated disclosure’s benefits are so modest that they would not justify much cost. We were thus already skeptical of the “at worst, harmless” hypothesis, believing that mandated disclosure is at *best* harmless—that is, only if its costs of implementation are low enough.

In the course of discovering some of the unintended consequences of mandated disclosure, we argued that it is not harmless, that it can be inequitable, that it can forestall better regulation, that it can destroy other protections, that it can crowd out more useful information, that it can foster opportunism, and that it can be anti-competitive. There is much evidence, even if sometimes anecdotal, for these harms. But there is also strong evidence that mandated disclosure does not only distort resource allocations, but that it actually causes many unnecessary deaths. The evidence comes from the disclosure regime regulated by “Institutional Review Boards” (IRB).

73 Comcast Agreement for Residential Services § 13 (October 2007).

The IRB is in some ways the acme of mandated disclosure, regulating and approving the exact wording of every disclosure and informed consent form researchers administer to prospective human subjects participating in medical trials and social science experiments. Proponents of the IRB regime think it “*necessary* to pursue *every* promising mechanism to *maximize* the protection of individuals participating in research,”⁷⁴ a belief that makes sense only if doing so is (as its proponents must assume) “at worst, harmless.”

However, the IRB system is harmful in crucial but little-noticed ways. We leave aside the large (but unremarked) administrative costs of a system that uses the services of thousands of doctors and other expensive people. They serve on the Boards as “volunteers,” the cost of whose time appears on no budget. The harm we describe here is harm to human well being, health, and life, and it comes directly from delaying research, forestalling research, and taxing researchers’ resources. The result is less experiments and trials, slower arrival at results, and delay in the discovery and approval of life saving treatments.

Numerous reports suggest that researchers can spend 15% of their research budget just negotiating with IRBs, money that could have been spend on research. Numerous reports also suggest that negotiating with IRBs can take so long that research is so delayed that research must be abandoned or abbreviated. Disclosure requirements also can delay research by making it hard to recruit subjects. A striking example comes from an international study on ways to treat heart attacks. To comply with the IRB informed consent regime, American researchers had to use more elaborate disclosures than researchers in other countries. This slowed recruitment of subjects in the United States so much that the study’s completion was delayed about six months. The study was successful: it confirmed that blood thinners reduce the mortality of hospitalized heart attach patients. The calculation is simple: about 20,000 Americans patients are eligible for this treatment every month, and we now know that about 75% of then receive the blood thinners. The treatment reduces the mortality rate by 5.6%, which means that over 800 lives are saved every month. Because of the IRB delays (it took time to approve the 1750-word disclosure form and to recruit participants), the experiment ended 8 months later than it would otherwise. Over 6400 lives were unnecessarily lost, in the U.S. alone, due to the delay.⁷⁵

Disclosure requirements also keep research from being conducted at all. For instance, nobody knows when umbilical cords of extremely low birth-weight babies

⁷⁴ Institute of Medicine, *Responsible Research: A Systems Approach to Protecting Research Participants* viii (National Academies Press, 2003).

⁷⁵ Rory **Error! Main Document Only**.Collins et al, *Ethics of Clinical Trials*, in C.J. Williams, ed, *Introducing New Treatments for Cancer” Practical, Ethical, and Legal Problems* 54 (Wiley, 1992); Simon N. Whitney and Carl E. Schneider, *Viewpoint: A Method to Estimate the Cost in Lives of Ethics Board Review of Biomedical Research*, *J. Internal Med.* (2011).

should be cut, so doctors must now decide arbitrarily when to do so. Nevertheless, the time of cutting may make a life-or-death difference to fragile human beings who weigh one pound. Eminent researchers, however, have concluded that effective disclosures are impossible in these emergency deliveries and therefore have not even asked for IRB approval to randomize patients and keep track of the results.

Finally, disclosure itself can fatally delay the treatment of research subjects. Thus in one study of head injuries, centers that did not make disclosures treated patients 72 minutes sooner than centers that did. The researchers estimated that even a shorter delay (of an hour) reduced “the proportion of patients who benefit from the trial treatment from 63% to 49%,” which meant “avoidable mortality and probably morbidity.” So “far from protecting the interests of patients participating in research, requirements for written informed consent and the resultant delay in starting treatment could be lethal.”⁷⁶

⁷⁶ **Error! Main Document Only.** Ian Roberts et al, *Effect of Consent Rituals on Mortality in Emergency Care Research*, 377 *The Lancet* 1071, 1071 (2011). In addition, **Error! Main Document Only.** the delay “obscure[d] a real treatment benefit from the administration of a time-critical treatment.”