“Information-Forcing Effects of Non-Disclosure Rules”

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Contract law traditionally applies different disclosure duties on buyers and sellers. Sellers are generally required to disclose “negative” information about hidden defects of the products they sell. Failure to disclose can make the contract voidable and can give rise to liability. By contrast, buyers are generally under no comparable duties to disclose “positive” information about hidden qualities of the products they buy. The leading explanation for the disparate treatment of buyers and sellers in these two asymmetric information problems is that disclosure duties on buyers would undermine their incentives to acquire costly (but socially useful) information prior to the contract (Kronman, 1978). The missing step in this explanation is the realization that by failing to correct asymmetric information problems, the inverse adverse selection problem, identified by Burckart and Lee (2016) and Dari-Mattiacci et al. (2021), would arise. Further, uninformed sellers would withdraw from the market and resources would not move to higher valuing uses. In this paper, we develop a model to study the incentives created by disclosure and non-disclosure rules. We show that when parties can contract around defaults, the choice of alternative disclosure rules (duty to disclose vs. no duty to disclose) makes a difference. Unlike disclosure rules, non-disclosure default rules yield partially separating equilibria that preserve the buyers’ incentives to acquire information. They also foster trade opportunities between expert buyers and uninformed sellers. Our results add to the existing literature by providing an additional rationale for the different treatment of buyers and sellers in asymmetric information problems.