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COURT OF APPEALS, DIVISION I
OF THE STATE OF WASHINGTON

STATE OF WASHINGTON,

Respondent,

v.

JOSEPH KAISER and HEIDI M. KAISER, husband and wife, G. HOBUS INVESTMENTS, LLC; BOBO BUYS REAL ESTATE, LLC; PRE FLOP LLC; and UNCLAIMED FUNDS, INC., a Washington Corporation,

Appellants.

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OPENING BRIEF OF APPELLANTS

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10. The trial court erred by making the holdings in Paragraph 11 of the Order on Summary Judgment. CP. 1039, ¶ 11.

[1] The Order on Summary Judgment has no Paragraph 8.

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2. If Kaiser had no fiduciary duties to the persons from whom he purchased parcels of real property, did he have the right to withhold deliberately acquired information about market conditions? (Assignment of Error No. 2)

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[2] In its Findings of Fact and Conclusions of Law ("Findings and Conclusions") the trial court did not separately identify findings of fact and distinguish them from conclusions of law. CP 1276-1285. Hence in these assignments of error, the trial court's holdings after trial are referred to with the acronym "FOF/COL."

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III. STATEMENT OF THE CASE

1. General background on Kaiser and his business activities

Joseph Kaiser ("Kaiser") is a real estate investor who specializes in properties facing foreclosure for failure to pay taxes. CP 821. Beginning in the late 1990s, he collaborated with former co-defendant Walter Scamehorn ("Scamehorn") to found and operate Fiscal Dynamics, Inc. ("Fiscal") and Cumulative, LLC ("Cumulative"). CP 837-38, ¶¶ 41-42. Working through these companies, Kaiser, Scamehorn, and a small number of other associates offered several different types of services to property owners facing tax foreclosure sales.

One of the services Kaiser and his associates offered was the outright purchase of properties on the verge of foreclosure. CP 823, ¶ 9. Although properties confronting an imminent tax foreclosure sale all share the characteristic that their owners have failed to pay property taxes, the properties are otherwise unique. Some contain the residence of their owner, others do not. Some appear to have potential value in excess of the taxes due, others are "junk" properties that face significant barriers to profitable development. CP 822, ¶¶ 5-6; CP 824, ¶ 10. Because of this variety in the properties at issue, it is not surprising that some of the owners simply want to sell the properties and get them off their hands. When such owners were willing to sell for what Kaiser considered a reasonable price, he was willing to buy. CP 824, ¶ 10, CP 831-32, ¶ 27.

For persons who wanted to remain living in a residence located on a property facing tax foreclosure, Kaiser offered a different set of services. Although each such transaction tended to have unique attributes, Kaiser's "partial interest deals" all involved his paying the taxes due in exchange for taking a partial interest (ranging from 25 to 50 percent) in the property. CP 832-33, ¶ 30. Typically, Kaiser's partial interest deals involved placing the property in a trust, for which Kaiser or one of his associated entities would serve as trustee. CP 632-33. Because the original owner was able to remain living in their home, and was not evicted as would have normally occurred if the property had proceeded to the foreclosure sale, Kaiser and his associates sometimes referred to this sort of transaction as a "foreclosure rescue." CP 866, lns. 13-14 (original owners not evicted), CP 832, ln. 24 ("foreclosure rescue").

Kaiser advertised his various services by sending letters and postcards to persons shown by county public records to be confronting a tax foreclosure sale. CP 122-137. Because Kaiser could not know in advance the particular circumstances of each recipient, his solicitation letters were quite general. The point of his letters was not to propose any particular type of deal, but to convey that Kaiser was knowledgeable about foreclosures, competent at helping the owner deal with them, and non-threatening. CP 825, ¶ 13. In addition to mailing solicitations, Kaiser performed some telephone solicitations, using an automatic dialing device to leave voice mail messages with potential customers. RP (12/10/08, afternoon), p. 64 ln. 21 to p. 67 ln. 1. Kaiser also markets various educational tools (seminars, newsletters, and web-sites) for paying customers interested in learning about foreclosure investment techniques. RP (12/10/08, afternoon) p. 3.

2. <u>The origins of this lawsuit</u>.

Kaiser estimates that between 1998 and 2008, he and his associates engaged in approximately 400 transactions with owners of parcels facing tax foreclosure. CP 821. Kaiser is proud of his record of doing deals that generated benefits for all parties, as evidenced by a paucity of consumer complaints about his activities. CP 821. *Cf.* CP 865-66 (citing only four "non-lawsuit complaints," and listing Kaiser or an affiliated entity as the plaintiff in 12 of the 15 lawsuits).

However, some of Kaiser's actions were controversial, at least for county auditors and treasurers. In particular, when Kaiser bought a property outright, he sometimes would simply let the property proceed to the tax sale, as was his right. CP 824. If the property sold at the tax sale for more than the amount of taxes due, Kaiser would claim the excess (the "overage"). Id. County officials often resisted paying on Kaiser's claims, asserting that RCW 84.64.080 required them to pay the overage to the record owner of the property at the time the tax delinquency was declared. CP 838, ¶ 42. Kaiser believes this resistance of county officials to paying his claims for tax overages is what initially attracted the attention of the Washington State Attorney General. CP 838, lns. 13-17.

The State of Washington filed its first complaint against Kaiser and his associates on March 14, 2007. CP 41-57. Shortly thereafter, Scamehorn, Fiscal, Cumulative, and the other individual defendants apart from the Kaisers entered a Consent Decree with the State. CP 593-606. The State subsequently filed first and second amended complaints against Kaiser and entities that remained under his control, alleging that various aspects of the overage transactions and partial interest deals violated the Washington State Consumer Protection Act ("CPA"). CP 76-92, CP 98-113. Kaiser answered and counterclaimed. CP 93-97, 666-82.[3]

[3] Kaiser's counterclaims were eventually dismissed with prejudice. CP 1108. Kaiser does not assign error to this dismissal.

3. Additional claims arising during litigation

One of the items regulated by the Consent Decree was the distribution and use of certain restitution funds contributed by Kaiser's former colleague Walter Scamehorn. The Consent Decree explicitly stated that "[a]ny consumer restitution funds remaining undistributed two hundred and seventy days (270) following entry of this Consent Decree shall be paid to the Attorney General . . . ." CP 599, lns 12-13.

Because of his work with tax overages, Kaiser had experience with local governments claiming moneys by virtue of escheat rules. CP 813.[4] As time passed after May 11, 2007 without any apparent effort by the State to contact the purported "victims," Kaiser became concerned that the State would keep the money pursuant to the express terms of the Consent Decree. CP 836-37. Accordingly, in late 2007 and early 2008, he used a new entity he had created, Unclaimed Funds, Inc., to send letters to a small number of persons he believed were entitled to a share of the restitution funds. CP 812, lns. 14-15, CP 837.[5] The letters offered help in claiming "unclaimed funds" in exchange for a contingent percentage fee. CP 612, 614, 616. Upon learning of these letters, the State amended its Complaint to allege that they constituted separate violations of the CPA. CP 107-08. At the same time, the State also amended its Complaint to bring in certain new entities through which Kaiser continued to do

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[4] The facts in Defendants' Memorandum in Opposition to Motion for Partial Summary Judgment were attested to under penalty of perjury by Joseph Kaiser. CP 818.

[5] The sources cited do not directly establish the number of such solicitations sent. However, Kaiser stated under penalty of perjury that there were exactly eight persons who fit the criteria for reimbursement set by the state. CP 812, lns 14-15, CP 818.

business: Unclaimed Funds, Inc., G. Hobus Investments, LLC, Bobo Buys Real Estate, LLC, and Pre Flop, LLC. CP 99-100. Later, the trial court allowed the State to amend its Complaint a third time to add a claim about Kaiser's phone solicitations. CP 1226-27.[6]

4. Decisions in the trial court

During the summer of 2008, Kaiser and the State stipulated that the upcoming trial could be bifurcated into a liability phase and a damages phase. CP 114-16. The State then filed a Motion and Memorandum of Authorities in Support of Partial Summary Judgment ("Motion for Summary Judgment") that focused primarily on Kaiser's overage transactions. CP 625-65. Kaiser effectively prepared his response to the Motion for Summary Judgment on his own, without meaningful assistance of counsel. CP 934-43, 1019-28.

Superior Court Judge Palmer Robinson granted the State's summary judgment motion in full on November 26, 2008. CP 1035-40. The matter then proceeded to trial before Superior Court Judge Michael Trickey on December 8th -11th, 2008, and January 12th -13th, 2009. Trial testimony focused on Kaiser's alleged liability for CPA violations based on his partial interest deals, as well as for four "other deals" that did not fit within the partial interest framework. Judge Trickey entered the Findings and Conclusions proposed by the State on February 2, 2009. CP 1276-85.

[6] The trial court found after trial that Kaiser's use of automatic dialing devices constituted a violation of the CPA. CP 1284, ¶¶ 34-35. Kaiser does not assign error to this conclusion.

The State was granted injunctive relief on February 11, 2009 (CP 1286-89), orders establishing penalties and restitution and awarding fees and costs were entered on May 6, 2009 (CP 2211-14, 2209-10), and final judgment was entered on May 29, 2009, 2009 (CP 2215-17). This appeal followed.

IV. SUMMARY OF THE ARGUMENT

Voluntary trades are mutually beneficial. Jack Hirschleifer *et al.*, *Price Theory and Applications*, p. 203, 410 (7th ed., 2005).[7] This basic economic insight not only explains how making profits and helping one's trading partners can go hand in hand; it also underpins the entire law of contracts. Critically, the law will enforce voluntary contracts even though one of the parties later changes her mind and wishes that she had struck a different or more advantageous deal. *See, e.g., Nat'l Bank of Wash. v. Equity Investors*, 81 Wn.2d 886, 912, 506 P.2d 20 (1973) (noting that "[o]ne cannot, in the absence of fraud, deceit or coercion be heard to repudiate his own signature voluntarily and knowingly fixed to an instrument whose contents he was in law bound to understand").

The Washington State Consumer Protection Act ("CPA"), under which the State has proceeded against Kaiser, does not deny the insight that voluntary trade is mutually beneficial, nor does it repeal the law expressed in *Nat'l Bank of Wash.* Instead, the CPA attempts to penalize or prevent trades that are not truly voluntary, without giving parties *carte-*

[7] Copies of the cited pages are attached to this Brief as Appendix A.

blanche to get out of contracts they have simply come to dislike. Accordingly, when the State brings a CPA claim, it cannot prevail simply by arguing that one of the parties to an exchange would have been better off not trading, or by asserting that anyone willing to deal with people fallen on hard circumstances must be a scam artist. Instead, the State has to show for each alleged CPA violation that the perpetrator committed an unfair or deceptive act, in trade or commerce, and that the unfair or deceptive act affected the public interest. It has to make these showings in a manner appropriate to either summary judgment or trial. This is precisely what it has not done with regard to Joseph Kaiser. As shown in detail below, many of the trial court's determinations that Kaiser violated the CPA were based on clear legal errors, overlooked genuine issues of material fact, or were unsupported by substantial evidence.

V. ARGUMENT

1. The State Must Show Three Essential Elements for Each Consumer Protection Act Violation

The Washington Consumer Protection Act ("CPA") prohibits "unfair or deceptive acts or practices in the conduct of any trade or practice." RCW 19.86.020. When the State brings an action under the CPA it bears the burden of proving three elements for each alleged violation. The State must show that: 1) there was an unfair or deceptive act or practice; 2) which occurred in trade or commerce; and 3) that this act or practice affected the public interest. *Robinson v. Avis Rent a Car*, 106 Wn. App. 104, 114 at n. 22, 22 P.3d 818 (2001).

Here, the trial court found that Kaiser committed approximately 66,216 distinct CPA violations, grouped into nine types. CP 2212-2213. The trial court's judgment is correct only if the State made a proper showing of each of the three required elements for each of these nine types of violation.[8] As is demonstrated in detail below, the State has failed to meet its burden for many of the nine types of alleged violation. Accordingly, this Court should reverse the trial court, vacate the judgment, and remand for further proceedings.

2. <u>The Standard of Review</u>

Summary judgment is only proper when there are no genuine issues of material fact and the moving party is entitled to judgment as a matter of law. CR 56(c). This Court performs a *de novo* review of trial court orders granting summary judgment. *Indoor Billboard/Washington, Inc. v. Integra Telecom of Washington, Inc.*, 162 Wn.2d 59, 170 P.3d 10 (2007). Accordingly, this Court should affirm the trial court's grant of summary judgment only if it determines, based on all of the evidence, that there are no genuine issues of material fact and that reasonable persons could only conclude in favor of the movant. *Vallandigham v. Clover Park Sch. Dist. No. 400*, 154 Wn.2d 16, 26, 109 P.3d 805 (2005).

[8] The existence of each of the three required elements for each of the nine types of violation is a necessary condition for the correctness of the judgment. It is not a sufficient condition, because individual alleged violations may not fit within their purported type. An argument of this second sort is advanced below at p. 39, note 28 (concerning unclaimed funds solicitations that had nothing to do with the restitution funds).

Findings of fact and conclusions of law entered after a bench trial are subject to a two-stage review. First, the Court must determine whether the trial court's findings are supported by "substantial evidence" in the record. *See, e.g., Pilcher v. Dep't of Rev.*, 112 Wn. App. 428, 435, 49 P.3d 947 (2002). Secondly, it must judge whether those findings support the conclusions of law. *Scott v. Trans-Sys., Inc.*, 148 Wn.2d 701, 707-08, 64 P.3d 1 (2003). Although this Court must defer to the trial court's determinations on the persuasiveness of the evidence, witness credibility, and conflicting testimony, it reviews of matters of law *de novo*. *Pardee v. Jolly*, 163 Wn.2d 558, 566, 182 P.3d 967 (2008).

3. <u>As a matter of law, Kaiser's overage transactions did not violate RCW 84.64.080, and even if they did, this would not constitute a *per se* violation of the CPA</u>

In its Order on Summary Judgment, the trial court determined that Kaiser violated the CPA by "intercepting tax overage funds in violation of the protections contained in RCW 84.64.080." CP 1038, ¶ 3. By so ruling, the trial court committed a two-fold error of law. First, Kaiser's claims to overage funds for properties that he owned in fee simple did not violate RCW 84.64.080. *See Stephenson v. Pleger*, 150 Wn. App. 658, 208 P.3d 583 (2009). Second, even if Kaiser <u>had</u> violated RCW 84.64.080, such a violation would not be a *per se* violation of the CPA. *See Hangman Ridge Training Stables, Inc. v. Safeco Title Ins. Co.*, 105 Wn.2d 778, 787, 719 P.2d 531 (1986).

RCW 84.64.080 regulates tax foreclosure sales, and provides in pertinent part as follows:

> If the highest amount bid for any such . . . lot is in excess of the minimum bid due upon the whole property included in the certificate of delinquency, the excess shall be refunded . . . to the record owner of the property. The record owner of the property is the person who held title on the date of issuance of the certificate of delinquency. *Assignments of interests, deeds, or other documents executed or recorded after filing the certificate of delinquency shall not affect the payment of excess funds to the record owner.*

RCW 84.64.080 (emphasis added). The trial court implicitly held that the italicized language meant that record owners had an inalienable right to any excess funds generated by a tax sale. CP 1038, lns. 3-5. By "intercepting" such funds, Kaiser allegedly violated both RCW 84.64.080 and the CPA. CP 1038, ln. 3.

Unfortunately for the State's position here, Division 2 of the Court of Appeals for the State of Washington recently rejected the argument that RCW 84.64.080 gives record owners an inalienable right to any overage resulting from a tax sale. *Stephenson*, 150 Wn. App. at 661 (holding that "the statute directs to whom the County must pay any overage following a foreclosure sale but does not create an ownership interest in the excess funds"). After first finding RCW 84.64.080 to be ambiguous "as to whether it prevents an assignee from becoming the legal owner of the sale proceeds," Division 2 looked to legislative history to conclude that

> the statute was not intended to determine ownership interests in the proceeds of a tax judgment foreclosure sale. Rather, it was intended to ease the job of the county treasurer because the statute had previously been 'ambiguous as to whether other creditors have rights to intervene and receive the refund before it goes to the record owner.'. . . [T]*he procedural nature of RCW 84.64.080 has no impact on determining the rightful owner of the proceeds.*

Stephenson, 150 Wn. App. at 663 (emphasis added). It follows that Kaiser was not acting in violation of RCW 84.64.080 in this case when he acquired fee ownership from "record owners" of properties facing tax foreclosures, nor did he violate that statute when he applied for overage funds for properties he owned at the time of the tax sale. The trial court erred when it concluded the contrary. CP 1038, ¶ 3.

Even if this Court should disagree with Division 2's opinion in *Stephenson*, and find that Kaiser's overage transactions violated RCW 84.64.080, this would not suffice to establish the first element of a CPA claim. As the State Supreme Court stated in *Hangman Ridge*, 105 Wn.2d at 787, it is "clear that the Legislature, not this court, is the appropriate body to . . . declar[e] a statutory violation to be a per se unfair trade practice." Neither RCW 84.64.080 nor any other provision in Chapter 84.64 RCW declares that violations of that Chapter are *per se* violations of the CPA. Thus, even if Kaiser's actions had infringed the statute, this fact by itself would not support liability under the CPA. The State would still have to establish the three required elements of a CPA violation.

4. There are genuine issues of material fact concerning whether Kaiser's overage transactions were deceptive, unfair, or unconscionable under the Consumer Protection Act

For the reasons indicated immediately above, the trial court erred as a matter of law when it determined that Kaiser's overage plays violated the CPA by virtue of allegedly violating RCW 84.64.080. However, the trial court also determined on summary judgment that the overage plays were unfair, deceptive, or unconscionable without regard to RCW

84.64.080. CP 1037, ¶ 2.[9] This holding, too, is in error, because there are genuine issues of material fact with regard to the first element of a CPA claim that prevent summary judgment. As is shown in more detail below, whether Kaiser's overage plays were deceptive, unfair, or unconscionable depends primarily on whether or not Kaiser had a fiduciary relationship with the persons from whom he purchased properties, at the time of the purchase. The existence of a fiduciary relationship is a fact question, and here the evidence precludes holding against Kaiser on summary judgment.

a) <u>Absent a fiduciary relationship, Kaiser's actions in the overage plays were not deceptive</u>

The gravamen of the State's claims about the supposedly deceptive nature of the overage plays, per se (as opposed to the solicitations for them, which are treated separately below), is that Kaiser failed to disclose material facts.[10] Allegedly, Kaiser "never tells owners about the overage or how much it could be." CP 648. The first part of this claim—that Kaiser never tells owners about the overage—is patently false, as is directly shown by the State's own exhibits of written contract documents, signed by the alleged "victims," explicitly discussing overages. CP 502, 513-14, 519, 528-31. The State's argument about Kaiser's purported

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[9] Paragraph 2 of the Order on Summary Judgment asserts that the overage plays were "unfair and unconscionable." The Summary Judgment Order's introductory paragraph, however, states that the enumerated acts and practices that follow were "unfair or deceptive." In addition, the trial Court's Order Imposing Penalties and Restitution refers to "unfair and deceptive overage transactions." CP 2212, ¶ 1. For the sake of completeness, the analysis that follows separately analyzes the potential "deception," "unfairness," and "unconscionability" of the overage plays.

[10] Because the trial court found that Kaiser's advertisements and solicitations constituted separate violations of the CPA, the advertisements and solicitations are treated separately below in Section 6.

deception thus reduces to the claim that he never told the owners about "how much [the overage] could be."[11]

This more modest claim calls for two responses. First, it is not a claim about concealment of an "existing fact." *See, e.g., Stienike v. Russi*, 154 Wn. App. 544, 563, 190 P.3d 60 (2008) (listing "representation of existing fact" as the first element of fraud) (emphasis added). At the time Kaiser and his customer reached their agreement for the sale of the property in question, the overage was merely a future prospect, not a fact. Kaiser had no concrete knowledge of what the overage would actually be, and therefore had nothing definite to conceal. The State's position effectively amounts to asserting that Kaiser was obligated to speculate about an unknown future value, a position for which Kaiser has been unable to find any case law support.

Second, even if the State's argument were construed to concern facts about existing market conditions (e.g., that tax foreclosure sales in general were very "hot", and that therefore most properties could be expected to generate substantial overages), Kaiser had no duty to disclose such facts *unless he had a fiduciary relationship with the persons with whom he was dealing.* It has long been the law in the United States that a

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[11] For example, the State alleged on summary judgment that there was "deception" involved in the Sagmoen transaction, but produced no evidence of any such deception apart from the difference between the price at which Kaiser purchased the property and the price at which it later sold at the tax auction. CP 647, CP 492-502. In effect, the alleged deception reduces to Kaiser not having disclosed possible knowledge of facts suggesting that the Sagmoens valued the property incorrectly. Compare Kaiser's account of this transaction in his declaration at CP 842-44.

purchaser of real or personal property in an arms-length transaction need not reveal private information about market conditions that could affect the value of the property being sold. The principle traces back at least to Chief Justice John Marshall's opinion in *Laidlaw v. Organ*, 15 U.S. 178, 194, 4 L.Ed. 214, 2 Wheat. 178 (1817). That case centered on whether a merchant who had private knowledge that the War of 1812 had ended was under a duty to disclose that information to another merchant from whom he bought a large quantity of tobacco. As Chief Justice Marshall put it:

> The question of this case is, whether the intelligence of extrinsic circumstances, which might influence the price of the commodity, and which was exclusively within the knowledge of the vendee, ought to have been communicated by him to the vendor? The court is of the opinion that he was not bound to communicate it.

By now, this passage from *Laidlaw* is recognized as articulating "about as fundamental a principle of commercial law as there is." *Williams Electronics Games, Inc. v. Garrity*, 366 F.3d 569, 580 (7th Cir. 2004) (Posner, J.) (explaining that "[p]eople would have little incentive to hunt for bargains if they had to disclose to the seller the true value of the seller's property").

The application of *Laidlaw* to Kaiser's overage transactions is direct and immediate: however much the State may believe Kaiser's withholding of information to have been distasteful, it was not a legally actionable "deception," provided only that the overage deals were done at arm's length. *See Liebergesell v. Evans*, 93 Wn.2d 881, 889, 613 P.2d 1170 (1980) (noting that "[g]enerally, participants in a business transaction deal at arm's length; it has been said that an individual has no particular duty to disclose facts . . . [when] he contracts at arm's length").[12] Here, Kaiser clearly had invested substantial effort in obtaining expertise at identifying properties which may be undervalued, and application of his expertise helped move properties to their most highly valued uses. The law typically does not punish use of such information, and in fact, rewards it. *See* Anthony T. Kronman, "Mistake, Disclosure, Information, and the Law of Contracts," 7 *Journal of Legal Studies* 1 (offering theory as to why the law generally protects deliberately acquired information about market conditions from forced disclosure) (a copy of this article is attached to this Brief as Appendix B).

b) There are genuine issues of material fact concerning whether Kaiser had a fiduciary relationship with his overage transaction counterparts

A fiduciary is "a person having a duty, created by his undertaking, to act primarily for the benefit of another in matters connected with his

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[12] The Kaisers are aware that a recent Washington Supreme Court case can be read as suggesting an absolute duty to disclose all material information in a contractual setting, regardless of whether there is a fiduciary relationship between the parties. In *Indoor Billboard,* 162 Wn.2d at 75, the State Supreme Court noted that "knowing failure to reveal something of material importance is deceptive within the CPA." Read literally, this statement appears to contradict *Laidlaw*. Since contract law is primarily within the competence of each state, the Washington Supreme Court has the power to overturn *Laidlaw* for contracts subject to Washington law. If it had done so, this Court would be obliged to follow. However, the statement in *Indoor Billboar*d is clearly dicta, since that case involved an affirmative misrepresentation, as opposed to a failure to disclose. *Id.* at 73 Moreover, tracing the origins of this dicta through the relevant cases, and in particular *Robinson*, 106 Wn. App. at 116, and *Hiner v. Bridgestone/Firestone, Inc.*, 91 Wn. App. 722, 730, 959 P.2d 1158 (1998), shows that Washington courts have not changed the law to require the disclosure of deliberately acquired information about market conditions regardless of whether or not there is a fiduciary relationship involved.

undertaking." *Van Noy v. State Farm Mutual Automobile Ins. Co.*, 142 Wn.2d 784, 797, 16 P.3d 574 (2001) (Talmadge, J., concurring). The existence of a fiduciary relationship between contracting parties creates a duty to disclose all material facts. *See, e.g., United States v. Dial*, 757 F.2d 163, 168 (7th Cir. 1984). If Kaiser had been the fiduciary of the persons from whom he bought the properties that he used for overage plays, then he would have had a duty to disclose material facts, possibly including facts about general market conditions.[13]

In some circumstances, fiduciary duties arise as a matter of law. *Liebergesell*, 93 Wn.2d at 890. Kaiser expects the State to argue that Kaiser's procurement of limited powers of attorney, executed by his contracting counterparts in order to ease Kaiser's application for overage funds, made him a fiduciary as to each entire overage transaction.[14] However, the powers of attorney were not in existence at the time Kaiser negotiated the transactions. Instead, they emerged as one of the components of the deal. *See, e.g.,* CP 502, CP 496. It makes no sense to conclude that simply because Kaiser was negotiating for a limited power of attorney that did not yet exist, he had fiduciary duties before the negotiations were consummated. Moreover, the powers of attorney that

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[13] But not including *non*-facts about merely possible future overage payments. See *supra*, p. 17.

[14] Because the trial court found that Kaiser's use of these powers of attorney constituted separate CPA violations, any such argument might suggest a double-counting of the relevant violations. Compare CP 1038, ¶ 2 and ¶ 5, and CP 2212, ¶ 1 and ¶ 6. In any event, the separate alleged violations created by Kaiser's use of the powers of attorney are discussed below in Section 7.

Kaiser secured as part of the overage deals were strictly limited. They only authorized Kaiser (or Fiscal Dynamics) to perform transactions—in particular, claiming the tax overage, if any—relating to the property that Kaiser had purchased in fee simple. CP 496. It would be error to conclude that these limited powers of attorney made Kaiser a fiduciary of his contractual counterparts with regard to the transaction as a whole.

Even though Kaiser was not a fiduciary as a matter of law, he might conceivably have been one as a matter of fact. *Liebergesell*, 93 Wn.2d at 891. However, "a contractual relationship does not generally create a fiduciary relationship." *37 Am.Jur.2d Fraud and Deceit § 34*. In this case, Kaiser was not related to his contractual counterparts, *cf. McCutcheon v. Brownfield*, 2 Wn. App. 348, 357, 467 P.2d 868 (1970); he was not friends with them, *cf. Gray v. Reeves*, 69 Wash. 374, 125 P. 162 (1912); nor did Kaiser share with them membership in any "secret fraternal order," *cf. Salter v. Heiser*, 36 Wn.2d 536, 542, 219 P.2d 574 (1950). More importantly, Kaiser explicitly announced to his counterparts that he was "participating in this transaction 'for profit' and would not enter into this transaction unless there existed the likelihood of earning a substantial profit." CP 502. *See also* CP 516-17 and 830-31, ¶ 24.

It follows that the persons with whom Kaiser dealt in the overage transactions simply had no reason to believe that he was acting "not in his own behalf, but [rather] in the interests of the other party." *Goodyear Tire & Rubber Co. v. Whiteman Tire, Inc.*, 86 Wn. App. 732, 742, 935 P.2d 628 (1997). See also *McGowan v. Pillsbury Co.*, 723 F.Supp. 530, 536

(W.D. Wash. 1989) (holding that assertion that defendant "has superior knowledge and offered to provide expert assistance" was not enough to create a fiduciary duty). At the very least, the evidence before the trial court, and in particular CP 502, 516-17, and 830-31, creates a genuine issue of material fact that bars granting summary judgment to the State on the grounds that the overage transactions were deceptive.

c) There are also genuine issues of fact that prevent summary judgment on the grounds that Kaiser's overage transactions were "unfair" or "unconscionable"

The trial court also found that the overage transactions were "unfair and unconscionable." CP 1037, ¶ 2. In determining whether an act or practice is unfair, Washington courts look to see

> (1) whether the practice, without necessarily having been previously considered unlawful, offends public policy as it has been established by statutes, the common law, or otherwise-whether, in other words, it is within at least the penumbra of some common-law, statutory, or other established concept of unfairness; (2) whether it is immoral, unethical, oppressive, or unscrupulous; (3) whether it causes substantial injury to consumers (or competitors or other businessmen).

Magney v. Lincoln Mutual Savings Bank, 34 Wn. App. 45, 57, 659 P.2d 537 (1983) (quoting *FTC v. Sperry & Hutchinson Co.,* 405 U.S. 233, 244, n. 5, 92 S.Ct. 898, 905, n. 5, 31 L.Ed.2d 170 (1972)).

Here, the arguments given immediately above concerning the purported "deceptiveness" of the overage transactions go a long way toward resolving the issue of "unfairness." In the absence of a fiduciary relationship (about which there is at least a genuine issue of fact), there is nothing "unlawful," "offensive to public policy," or "immoral, unethical, oppressive, or unscrupulous" about not disclosing deliberately acquired information concerning market conditions or property values. On the contrary, bargain hunting, even searching for "real steal deals," serves the purpose of fostering the movement of resources to their most highly valued uses. A successful bargain hunter deserves his or her reward. *See, e.g., Dial*, 757 F.2d at 168. Nor did Kaiser's overage deals cause "substantial injury" to his contractual counterparts.[15] His counterparts concluded that an amount certain, in hand, was preferable to the chance of a larger payoff at some point in the future. CP 502, 513. There is no dispute that Kaiser always paid the amounts he promised, and the fact that some of the people with whom he traded later changed their minds is no evidence that they were actually harmed.

As for unconscionability, the State mischaracterized the law when it cited to *Nelson v. McGoldrick*, 127 Wn.2d 124, 131, 896 P.2d 1258 (1995) for the proposition that "[t]he Court may decide unconscionability at summary judgment." CP 649, lns. 11-13. Although it is true that *Nelson* lifted the flat prohibition on resolving unconscionability at summary judgment that had been imposed by *Schroeder v. Fageol Motors, Inc.*, 86 Wn.2d 256, 262, 544 P.2d 20 (1975) (holding that in the UCC context "a court is not authorized to dispose of this [unconscionability] issue under

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[15] The State's insinuation that some or all of Kaiser's overage deals were with "vulnerable adults" is without evidentiary foundation. See CP 648, n. 13, citing to *Endicott v. Saul*, 142 Wn. App. 899, 176 P.3d 560 (2008) (a case involving an eighty year old woman defined as a "vulnerable adult" under RCW 74.34.020).

the rules governing summary judgment"), it did so in a way that is clearly unhelpful to the State in this case.

What the *Nelson* court actually said was this:

> We conclude that summary judgment may, under some circumstances, be appropriately granted *to a plaintiff even in the face of a claim that a contract is unconscionable. We need not decide, however the question of whether summary judgment could properly be granted to a defendant* where the record at the summary judgment proceeding, unlike in *Schroeder*, is fully developed on the defense of unconscionability.

Nelson, 127 Wn.2d at 133 (emphasis added). In *Nelson*, the plaintiff was seeking to enforce a contract, and was doing so against an alleged defense of unconscionability. By holding as it did, the *Nelson* court endorsed the proposition that the party asserting unconscionability may properly lose at summary judgment "absent a [sufficient] threshold showing of unconscionability." *Id.* (citing to *Jeffery v. Weintraub*, 32 Wn. App. 536, 542-43, 648 P.2d 914 (1982). In contrast, *Nelson* does not stand for the proposition that a party asserting unconscionability could properly win at summary judgment, which is the proposition that the State needs. Instead, the *Nelson* court plainly said that it "need not decide" that issue, which leaves the *Schroeder* prohibition in effect to bar winning a judgment of unconscionability on a CR 56 motion. *Nelson*, 127 Wn.2d at 133.

Consistent with this interpretation of *Nelson*, counsel for the Kaisers has been unable to find any published case applying Washington law in which the party asserting unconscionability has won on that issue at summary judgment.[16] *See, e.g., M.A. Mortenson Co. v. Timberline Software Corp.*, 140 Wn.2d 568, 586, 998 P.2d 305 (2000) (citing *Nelson* for the proposition that "if there is no threshold showing of unconscionability, the issue may be determined on summary judgment," and going on to uphold grant of summary judgment to the party denying unconscionability). Accordingly, the trial court erred as a matter of law in so far as its grant of summary judgment regarding Kaiser's overage transactions depended on their alleged unconscionability.

Even if the trial court could have properly addressed the unconscionability issue on summary judgment, the facts in evidence and the reasonable inferences derived from those facts do not support summary judgment for the State. This is true regardless of whether the Order on Summary Judgment is construed to have found the overage transactions substantively or procedurally unconscionable, or both. *See* CP 1037-38 (asserting the overage transactions were unconscionable, but not specifying of which sort). *Compare Adler*, 153 Wn.2d at 344-47 (distinguishing between the two types of unconscionability, and discussing whether they must both be found together).

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[16] *Adler v. Fred Lind Manor*, 153 Wn.2d 331, 103 P.3d 773 (2005), *Mendez v. Palm Harbor Homes, Inc.*, 111 Wn. App. 446, 45 P.3d 594 (2002), and *Luna v. Household Finance Corp. III*, 236 F.Supp.2d 1166 (W.D. Wa. 2002) provide no support to the State's position on this point. All of these cases involved rulings on motions to compel arbitration. Because unconscionability is a defense to the enforcement of an arbitration agreement, it is an issue that must be summarily determined by the court if raised by a motion to compel. See *RCW 7.04A.070 (1)*. There is no similar statutory requirement that the unconscionability of a contract for something other than arbitration be summarily determined.

Arguably, the trial court focused on purported substantive unconscionability, as the Order on Summary Judgment asserts that "overage money, but for Defendants' transaction, would have gone directly to the owner without any deductions, and Defendants have provided nothing of value to the owner in exchange." CP 1037-38. Conceptually, at least, this assertion fits within the framework of substantive unconscionability, which looks to whether "a clause or term in the contract is . . . one-sided or overly harsh." *Adler*, 153 Wn.2d at 344. Factually, however, there is no evidence to support the accusation.

Kaiser purchased the overage properties for good and valuable consideration. See, e.g., CP 497 (Box 3(e)), 513, and 806. Once he owned the properties, Kaiser had the right—like any other property owner in arrears on taxes—to choose whether to pay the taxes or let the property go to foreclosure auction. The prior owner, having sold the property, had no interest whatsoever in Kaiser's choice. CP 824, ¶ 10. Put another way, part of what the sellers gave up when they sold the properties at issue was any interest in the prospect of an uncertain future overage. The State clearly believes that the sellers acted irrationally in trading those uncertain prospects for mutually agreed, certain cash payments, but that belief is not evidence—it's just a manifestation of the State's paternalism.[17]

[17] The State's paternalistic attitude toward citizens facing foreclosure is not based on any law that this Court is obliged to follow in this case. In particular, RCW 19.86.920, which can be read as requiring courts to "liberally construe [] . . . [the CPA] to protect the public," does not necessitate that courts endorse measures that actually harm the public by restricting the options available to persons facing foreclosure. See *State Farm Fire and Casualty Co. v. Huynh*, 92 Wn. App. 454, 458, 962 P.2d 854 (1998). Compare *RCW*

Moreover, the evidence in the record suggests that Kaiser's bidding at the tax sales had the effect of increasing the overage amounts, so that it is not true that the former owners would have reaped the same amount at an auction as did Kaiser. CP 810. Accordingly, the evidence at the very least creates genuine issues of fact about whether the overage deals were substantively unconscionable.

The evidence also creates genuine issues of fact about any claimed procedural unconscionability affecting the overage transactions. Procedural unconscionability is concerned with "the lack of a meaningful choice, considering all the circumstances surrounding the transaction." *Adler*, 153 Wn.2d at 345. To the extent this "lack of meaningful choice" is analogous to duress, it is critical to note that the State does not even allege that Kaiser coerced people into selling him their properties. Instead, the State's position seems to be that Kaiser somehow improperly took advantage of coercion caused by circumstances beyond his control.[18] CP 649. But all that Kaiser did was to offer persons confronting

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61.34.060, which entered into effect after this action commenced, which does require courts to enforce measures that restrict the options of persons facing foreclosure.

[18] The case on which the State relies to support the proposition that general financial pressure on one of the parties to a contract can suffice to make that contract procedurally unconscionable, *Nagrampa v. MailCoups, Inc.*, 469 F.3d 1257 (9th Cir. 2006), was applying California state law, not federal law. *Nagrampa*, 469 F.3d at 1280. RCW 19.86.920 does not require Washington courts to be guided by California law when interpreting the CPA. Whether or not *Nagrampa* supports the asserted proposition as a matter of California law is not entirely clear, but in any event, Washington courts applying Washington law appear to reject this proposition. *See, e.g.*, *Adler*, 153 Wn.2d at 347-48 (analyzing lack of "true equality of bargaining power"—one channel through which the financial constraints on a party could make themselves felt—as one factor in determining whether or not a contract is adhesive, but holding that "the fact that an agreement is an adhesion contract does not necessarily render it procedurally unconscionable").

foreclosure new, additional options, options that he had no power to force them to take. If people took up Kaiser's offer, it was because they believed it to be their best option.[19] The State has produced no evidence showing that the sellers lacked the capacity to make a rational choice of this sort, and—as discussed above and below in Section 6—there are at least genuine issues of fact concerning whether Kaiser practiced any deceit. It follows that there are genuine issues of fact that bar summary judgment on the grounds of any alleged procedural unconscionability.

In sum, then, the trial court erred in granting summary judgment on the issue of the alleged "unfair and unconscionable," or deceptive, overage transactions. Kaiser's failures to disclose possible overage outcomes were not deceptive unless he had fiduciary duties to his contractual counterparts, and there are genuine issues of material fact on that score. Similarly, there are genuine issues of material fact about the unfairness or unconscionability of the transactions, and in any event, unconscionability cannot properly be affirmatively established on summary judgment. Accordingly, the trial court erred in concluding on summary judgment that the overage transactions violated the CPA.

[19] The State's claim that Kaiser's "victims" "lack[ed] choice given the impending loss of their property" is logically unsustainable, since on the very same page where the State makes this claim it goes on to assert that the sellers would have been better off to let their properties go to auction than to deal with Kaiser. CP 650. Again, the State's position reduces to naked paternalism: it doesn't like the choices made by the people with whom Kaiser dealt, but it has no evidence or valid argument that shows those choices were coerced by Kaiser, and its arguments that the choices were produced by deception are at least subject to genuine issues of material fact.

5. <u>The trial court erred both in the manner and substance of its holding that Kaiser's partial interest transactions do not result in homeowners keeping their homes</u>

In its Findings and Conclusions, the trial court asserted that "[t]he Court has *already found* that Kaiser's transactions do not result in homeowners keeping their home." CP 1277, ¶ 3 (emphasis added). It then went on to explain this purported previous finding as follows:

> In the [Order on Summary Judgment], the Court found that Mr. Kaiser violated the Consumer Protection Act, RCW 19.86.020, by soliciting homeowners with false promises to help them keep or save their home when partial interest deals do not actually result in the homeowner keeping or saving their home.

CP 1277, ¶ 3. However, the Order on Summary Judgment does not directly state that Kaiser's partial interest deals failed to result in homeowners keeping or saving their homes. CP 1036, ¶ 1.

Kaiser understands that the trial court had the discretion to correct errors in judgments "arising from oversight or omission . . . at any time." CR 60(a). Kaiser also acknowledges that the trial court's re-statement of its holding on summary judgment <u>may</u> "embod[y] the trial court's [original] intention." *Presidential Estates Apartment Assoc. v. Barrett*, 129 Wn.2d 320, 326, 917 P.2d 100 (1996) (holding that this relation to the trial court's original intent, as expressed in the record, is the key to determining whether a mistake is a "clerical" error that can properly be corrected under CR 60(a)). However, even the State, which prepared both the Order on Summary Judgment and the Findings and Conclusions, did not initially understand the Order on Summary Judgment to hold that Kaiser's partial interest transactions do not result in homeowners keeping their home.[20] In these circumstances, the trial court should have given notice and invited comment prior to revising the Order on Summary Judgment. It abused its discretion by failing to do so.

Even if the trial court did not abuse its discretion in retroactively adding a holding to the Order on Summary Judgment, it erred by concluding that Kaiser's partial interest transactions "do not actually result in the homeowner keeping or saving their home" (CP 1277, ¶ 3), because the State concedes that "[i]t is true that Kaiser has allowed most people to remain in their home[s]." CP 866, lns 13-14. This concession is fatal to the trial court's (implied) grant of summary judgment on the issue of whether people can "keep" or "save" their homes by doing partial interest deals with Kaiser. Clearly, there is strong factual evidence that such people have kept or saved their homes, because the State concedes they remain living in them.[21] Although the State tries to mitigate the effect of its concession by arguing that Kaiser's actions simply reflect his intent to let the passage of time ratify what would otherwise be unenforceable

[20] In its trial brief, the State did not claim that the court had already determined that Kaiser's partial interest deals did not result in the homeowners keeping their homes, but instead focused on the court's determination that Kaiser's solicitations were misleading CP 1045-46. Also, the State's first proposed Findings of Fact and Conclusions of Law submitted before trial included a third paragraph that did not make the same assertion as the third paragraph in the final version. Compare CP 1095, ¶ 3 and CP 1277, ¶ 3. Finally, the State initially described the Order on Summary Judgment as "declar[ing] that 23 of Defendants' practices violate the Consumer Protection Act." CP 1042, ln. 4. The actual Findings of Fact and Conclusions of Law increase this number to 24. CP 1276, ln. 22. This increase may well trace to the assertion that the court had also determined that the partial interest transactions did not result in homeowners keeping their homes.

[21] A "home" is commonly understood as a place of abode, and has no intrinsic connection to ownership (so for example, a "homeless" person is a person who lacks a place to reside, not someone who does not own a home).

deals, that intent is very much disputed. CP 866, lns. 13-19 (the State's argument about Kaiser's intent); CP 832, ¶ 30 to 835, ¶ 35 (Kaiser's discussion of his intent). This dispute poses a genuine issue of material fact which should have prevented summary judgment.

6. <u>There are at least genuine issues of material fact as to whether Kaiser's advertisements and solicitations were deceptive under the Consumer Protection Act</u>

The trial court also determined on summary judgment that twelve different types of solicitation used by Kaiser were deceptive and violated the CPA. CP 1036-37, ¶ 1(a)-(l). Whether a given action constitutes a violation of the CPA is typically a question of law. *See, e.g., Leingang v. Pierce County Medical Bureau*, 131 Wn.2d 133, 150, 930 P.2d 288 (1997). However, the evaluation of the deceptiveness of solicitations or advertisements necessarily involves comparing and contrasting the claims made with services or goods actually provided. *See, e.g., Fisher v. World Wide Trophy Outfitters, Ltd.*, 15 Wn. App. 742, 745-46, 551 P.2d 1398 (1976) (viewing advertisements for game hunting expeditions "in light of what happened during the hunt"); *and United States v. Ninety-Five Barrels (More or Less) Alleged Apple Cider Vinegar*, 265 U.S. 438, 44 S.Ct. 529, 68 L.Ed. 1094 (1924) (comparing barrel labels with barrel contents). Since there are material fact questions about the meaning of Kaiser's statements and the nature of his actions, summary judgment was inappropriate. *See, e.g., State v. Burlison*, 38 Wn. App. 487, 491, 685

P.2d 1115 (Div. 2, 1984) (overturning summary judgment on claim of deceptive advertising concerning laundry detergent).[22]

In determining that Kaiser's ads were deceptive, both the State and the trial court focused on his claims to be able to "help" property owners solve real estate problems or stop foreclosures. CP 645-46 (State's Motion and Memorandum, counting 16 uses of the term "help" and 32 cases of similar terms or phrases); CP 1036-37 (Order on Summary Judgment, using variants of the term "help" or "assist" in nine of the twelve holdings regarding solicitations). Effectively, the trial court concluded that the claims to provide help were deceptive because (1) they implied that Kaiser worked for free, when in fact he did not; and (2) Kaiser in fact provided nothing of value to his customers. Both conclusions involve the resolution of questions of material fact that is improper at summary judgment.

First of all, there is nothing about the advertisements that would lead a member of the general public—no matter how "ignorant," "unthinking," or "credulous"—to conclude that Kaiser was offering to work for free, or exclusively for the benefit of the customers. *Cf. Charles of the Ritz, et al. v. FTC*, 143 F.2d 676, 679 (2nd Cir. 1944). Kaiser does not say that he is working for free, nor does he claim to be associated with any non-profit entity or charity. He does offer to "help," but this is such a standard claim in the for-profit service professions (attorneys will "help"

[22] See also *Com. by Corbett v. People's Benefit Services, Inc.*, 923 A.2d 1230, 1243 (Pa. 2007) (concluding that "the question of whether [defendants'] advertisements and solicitations have a tendency to confuse or mislead recipients . . . depends on matters of material fact that remain in dispute").

secure justice, personal trainers will "help" procure weight loss, etc., etc.) that hardly anyone would conclude from the use of this term alone that Kaiser was offering to work for free. Kaiser's use of the term "help" does not have a capacity to deceive about the for-profit nature of Kaiser's activities, and summary judgment was improper on this score.

Second, although the State asserts that Kaiser provided nothing of value to his customers, the evidence easily establishes genuine issue of fact about this contention as well. As discussed above, Kaiser's overage transactions involved paying his counterparts consideration that they considered to be at least adequate. *Supra*, p. 26; CP 497, 529. Also, Kaiser's partial interest transactions allowed his customers to stay on as residents in homes that they otherwise would have lost to foreclosure. CP 385, 866 lns. 13-14. As a consequence, reasonable finders of fact could determine that Kaiser's use of the term "help" was not deceptive, because there is ample evidence that he actually did provide benefits to the people with whom he dealt.

The State also alleged, and the Court found on summary judgment, that several other solicitations sent by Kaiser violated the CPA for reasons other than their use of the terms "help" and "assist." For example, the trial Court found that the first and second "Wonder Woman" solicitations "falsely claim[] Tina Worthey is like a superhero." CP 1037, lns. 4-8. Assuming for the sake of argument that the solicitations at issue make this claim and that it is false, the relevant question is whether the claim had the capacity to deceive a substantial portion of the public.[23] *Hangman Ridge*, 105 Wn.2d at 785. At the very least, reasonable fact finders could disagree about this issue, rendering summary judgment inappropriate.

There is also both a factual issue as to whether the "Hike an Extra Mile Solicitation" falsely stated the extent of Kyle Yarborough's experience, *cf.* CP 1037, lns. 14-16 and CP 828-29, and a legal question as to whether any such exaggeration could be materially deceptive. *See Holiday Resort Community Ass'n. v. Echo Lakes Assocs., LLC,* 134 Wn. App. 210, 226, 135 P.3d 499(2006) (noting that "[i]mplicit in the definition of 'deceptive' under the CPA is the understanding that the practice misleads or misrepresents something of material importance").

Finally, the trial court also erred in concluding that the two "False Names solicitations" violated the CPA. CP 1037, lns 17-20. The reason offered by the State to support this conclusion is that "[i]t is also a deceptive practice to use a fictitious name." CP 644. A moment's reflection suffices to show that this can't possibly be a correct statement of the law, even if one were to add the restrictive clause "in business or trade" (e.g., "it is a deceptive practice to use a fictitious name in business or trade"): the fact that the Attorney General isn't going after Aunt Jemima, Betty Crocker, McDonald's, or Wendy's conclusively refutes it.

[23] Compare the "Wonder Woman solicitations" with the advertisements for "Superlawyers" taken from various issues of *Washington Laws and Politics*, attached to this Brief as Appendix C. Ordinary humans will not think these ads suggest that the lawyers involved work for free, nor will they believe they are really endowed with superhuman powers.

Moreover, the case law the State cited in support of its proposition actually does no such thing. CP 644, lns. 6-9. *Floorsheim v. FTC*, 411 F.2d 874, 876-77 (9th Cir. 1969) involved fictitious titles of documents (e.g. "Claimant's Information Questionnaire") that were themselves found to improperly simulate government forms; *State v. Kay*, 115 N.H. 696, 350 A.2d 336 (N.H. 1975) involved a false signature on a "vacation certificate" exchanged for money; and *Com. By Packel v. Tolleson*, 14 Pa.Cmwlth. 72, 321 A.2d 664 (1974) concerned "utilization by the [defendants] of . . . many . . . corporations, organizations and fictitious [business] names without full disclosure to their prospective customers," in a context where it had been "specifically found that [defendant] has changed his many organizations and operations in [the state] to avoid court orders and evade the law." *Id.* at 694, 688.

None of these cases support the proposition that the State needs: that use of a fictitious person's name in an advertisement is necessarily deceptive. Indeed, the law on this issue is clearly to the contrary. The common law allowed a person to transact business under any name provided that there was no fraudulent design or intent to injure. 57 *Am.Jur.2d* Name § 64. Courts in Ohio, interpreting a statute similar to Washington's CPA, have held that "an entity's use of a fictitious name may be deemed a deceptive and unfair practice only when used by the entity in connection with some effort to avoid its responsibilities to consumers." *Charvat v. Farmers Insurance Columbus, Inc.*, 178 Ohio App.3d 118, 138, 897 N.E.2d 167 (2008). The most closely related

Washington law appears to be Chapter 19.80 RCW, the trade name registration act. The legislature has nowhere declared that failure to comply with the registration requirements of this act constitutes a *per se* violation of the CPA. Because the State has identified nothing deceptive about the "False Names" solicitations, the trial court erred as a matter of law in concluding that the mailing of these postcards violated the CPA.[24]

7. Kaiser's use of limited powers of attorney in connection with the overage transactions did not violate the CPA

Kaiser's overage transactions involved the outright purchase of properties which he then allowed to proceed to tax foreclosure auction, as was his right. Because many county clerks insisted on an incorrect interpretation of RCW 84.64.080, they often refused to pay Kaiser the overage money due after the sale. CP 844, ¶ 57; see also *Stephenson*, 150 Wn. App. at 663 (holding that "RCW 84.64.080 has no impact on determining the rightful owner of the proceeds"). In order to avoid this problem, Kaiser began to obtain limited powers of attorney from the sellers of the property. See, e.g., CP 496. These limited powers of attorney were restricted to giving Kaiser powers related to the properties sold. Id.

The critical fact about these powers of attorney is that former owners, by virtue of their transfers of title, had no interest in the subject of the powers granted. They no longer owned the property, and *a fortiori*,

[24] These postcards clearly do not make actionable "promises to buy" property. CP 136-37.

they no longer had a claim to any overage that might possibly accrue at a possible future tax sale (just as they would have had no interest in the property itself, if Kaiser had decided to pay the taxes and keep the property). Because the former owners no longer had any interest in the properties, or in the overages, Kaiser did not breach any duty to them by his use of the powers of attorney to attempt to persuade county clerks to comply with the law and pay him the overage. The trial court erred as a matter of law in granting summary judgment on this issue. CP 1038, lns. 9-11.

8. <u>Kaiser's use of attorneys in connection with the overage transactions did not violate the CPA</u>

For the essentially the same reasons as set forth in Section 7 immediately above, Kaiser's use of attorneys in connection with the overage transactions did not violate the CPA. Kaiser purchased the properties believing that by doing so he acquired the right to any overage. CP 824. If he had not believed this, he might not have bought the properties. If he had not bought the properties, the sellers would not have received the benefit of the immediate, certain cash payment that the sellers decided was worth more to them than the uncertain future prospect of getting the surplus from a tax sale. CP 843, ¶ 54. Because of the position taken by county clerks, Kaiser determined that the whole transaction would be facilitated by use of an attorney representing the seller to handle the claim for the overage. This use was effectively a precondition of the deal, a precondition of the benefit to be received by the prior owner.

Neither Kaiser nor the attorneys involved violated any duty to the prior owners. Here, too, the trial court erred in granting summary judgment.

9. Kaiser's restitution fund solicitations lacked the capacity to deceive the public

The trial court also determined on summary judgment that Kaiser's solicitations regarding restitution funds created by the Consent Decree were misleading and in violation of the CPA. CP 1038-39. However, "as a matter of law, conduct directed toward a small group cannot support a CPA claim." *Swartz v. KPMG LLC*, 401 F.Supp.2d 1146, 1154 (W.D. Wa. 2004) (citing to *Henery v. Robinson*, 67 Wn. App. 277, 289-91, 834 P.2d 1091 (1992) and *Micro Enhancement International, Inc. v. Coopers & Lybrand, LLP*, 110 Wn. App. 412, 438-39, 40 P.3d 1206 (2002)); *affirmed in part and reversed in by Swartz v. KPMG LLC,* 476 F.3d 756, 761 (9th Cir. 2007) (endorsing trial court disposition of CPA claim). Given the limited number of solicitations Kaiser sent regarding the restitution funds and their inherently individualized character, they lacked the relevant capacity to deceive as a matter of law.[25]

[25] Kaiser's submissions to the trial court at summary judgment do not explicitly state the number of restitution fund solicitations he distributed. However, Kaiser affirmed that there were "exactly eight sellers fitting" the State's criteria for restitution. CP 812 lns. 14-15. Compare *Micro Enhancement*, 110 Wn. App. at 438-439 (implicitly finding that mailing of allegedly deceptive proposal letter to a total of nine recipients did not suffice to show capacity to deceive a substantial portion of the public). By contrast, on summary judgment the State presented no evidence on the number of relevant solicitations. Kaiser is entitled to the reasonable inferences from his facts, and it is reasonable to infer that he sent the restitution funds solicitation to eight persons or fewer. The total number of "unclaimed funds" solicitations Kaiser sent on all matters is irrelevant. *Cf.* Kaiser's answer to Interrogatory No. 4 in Plaintiff's Second Set of Interrogatories, in which Kaiser responded that there were "hundreds" of persons who had received some sort of communication from Unclaimed Funds, Inc. CP 1905. Kaiser's evidence makes it clear that Unclaimed Funds, Inc., sent solicitations with regard to other matters besides the

Even if this Court does not conclude that the CPA claims based on these solicitations fail as a matter of law, there are genuine issues of fact that bar summary judgment. For example, there is a factual question as to whether Kaiser's assertion that "the unclaimed funds will very soon escheat to . . . the agency currently holding them" was deceptive. CP 612. The Consent Decree explicitly said that funds that remained undistributed 270 days after entry of the decree "shall be paid to the Attorney General" for non-restitutionary uses. CP 599, lns. 12-17. There can be no doubt that the Consent Decree was "entered" on May 11, 2007, and that upon entry it took on the force and effect of a judgment.[26] Considered in the light of all the circumstances, Kaiser's claim was not deceptive: there was a real risk that the funds would cease to be available for restitution after the 270 day term expired.[27] Nor did Kaiser make any <u>material</u> misrepresentation when he stated that he had required forms and that he had learned about the funds through public records requests. *See Holiday Resort Community Ass'n.,* 134 Wn. App. at 226 (holding that actionable misrepresentations must be material).[28]

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restitution fund established by the Consent Decree. CP 813, lns. 8-13 (discussing case of Mallia Booi). A copy of the complaint in the Booi matter, retrieved from Pierce County LINX, is attached to this Brief as Appendix D.

[26] For example, the Consent Decree conformed to the requirement of CR 54(b) that "entry of a final judgment as to one or more but fewer than all of the claims or parties" must be accompanied by "an express determination . . . that there is no just reason for delay." Cf. CP 595, ln. 13.

[27] As part of its summary judgment pleadings, the State submitted an affidavit asserting that it "presently intends" to distribute the restitution money after more is collected, but the affidavit did not opine on what the Attorney General's office intended to do with the funds prior to Kaiser's intervention. CP 608, ln. 25.

[28] Even if this court should conclude that the Unclaimed Funds solicitations sent by Kaiser related to the restitution fund were in fact deceptive, there is no basis for

10. Kaiser's manner of executing real estate excise tax forms also lacked capacity to deceive the public

The fact that "conduct directed toward a small group cannot support a CPA claim" also bars summary judgment with regard to Kaiser's manner of filling out real estate excise tax forms. *Swartz*, 401 F.Supp.2d at 1154. The state's evidence on summary judgment shows that on four occasions, Kaiser or an associate submitted Real Estate Excise Tax Affidavits for these deals that claimed the underlying transactions were exempt from tax pursuant to WAC 458-61A-211 or WAC 458-61-375(2i). CP 568 (Darling), CP 585 (Worthey testifying about Klein), CP 587 (Millet), CP 589 (Yaws).[29] Because of the idiosyncratic nature of these transactions and their limited number, Kaiser's actions with regard to them lacked the capacity to deceive a substantial part of the public. Accordingly, the State's CPA claim based on these transactions fails.[30]

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concluding that Kaiser sent 500 such solicitations. Cf. CP 2213, lns. 3-4. In response to an Interrogatory asking Kaiser to identify each recipient of letters from Unclaimed Funds, Kaiser answered that there would be hundreds. CP 1905. However, the State did not ask Kaiser how many Unclaimed Funds solicitations he sent were related to the restitution fund. Since this issue was determined on summary judgment, Kaiser is entitled to the reasonable inference that he sent fewer than eight such solicitations. CP 812 lns. 14-15.

[29] The purported transcript of what appears to be an instant messaging exchange between Kaiser and his employee Sara Larson, contained at CP 591, does not refer to claiming exemptions from excise taxes. Also, the Declaration of James T. Sugarman in Support of Plaintiff's Motion for Penalties and Restitution, and in particular Exhibit 4 thereto, were not before the trial court on summary judgment. CP 1516-17, 1665-94. If they had been, there might have been questions about the extent of Kaiser's responsibility for excise tax affidavits executed by Walter Scamehorn. CP 1667, 1675, 1678, 1679, 1681, 1683, 1685, 1686.

[30] The State also fails to meet its initial burden on summary judgment with regard to the public interest element of these acts under the CPA. The State did not make any argument about the public interest element with regard to the tax affidavits in its summary judgment motion and memorandum. CP 656-658. Assuming for the sake of argument that the four affidavits constitute violations of Chapter 82.45 RCW, that statute does not does not declare that violations satisfy the public interest element per se. *Cf.*

11. <u>The trial court erred as a matter of law when it concluded that Kaiser violated the CPA simply by *being* both the trustee and a beneficiary of the partial interest trusts</u>

Paragraph 7 of the Order on Summary Judgment holds that Kaiser engaged in unfair or deceptive acts in violation of the CPA by:

> *acting as* both trustee and co-beneficiary seeking a profit on land trust agreements used in partial interest deals, in violation of their fiduciary duty as an agent to act exclusively in their principal's interest and not seek personal profit from their relationship

CP 1035, 1038 ¶ 7 (italicized emphasis added). Although the Order on Summary Judgment refers to Kaiser "acting as" both trustee and co-beneficiary, neither that order nor the State's Motion for Summary Judgment identifies any particular *actions* taken by Kaiser in violation of his fiduciary duties. *Cf.* CP 659-60. At the invitation of the State, the trial court used "acting as" synonymously with "serving as" or simply "being." In other words, the State alleged, and the trial court found, that Kaiser violated the CPA just by *being* both trustee and beneficiary of the partial interest trusts.

Neither the case law cited by the State in the relevant section of its Motion nor any found by Kaiser's counsel supports the claim that a person can violate the CPA simply by being both the trustee and a beneficiary of a trust. Although there is authority to the effect that holding both positions creates potential conflicts of interest, that same authority makes it clear

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Hangman Ridge, 105 Wn.2d at 791 (holding that "a legislative declaration of public interest is required to satisfy the public interest element per se").

that there is no blanket prohibition on being so situated. *See, e.g.*, William F. Fratcher, II *Scott on Trusts*, § 99.3 (4th ed. 1987), pp. 63-64.[31] See also *In the Matter of the Estate of Drinkwater*, 22 Wn. App. 26, 31-32, 587 P.2d 606 (1978) (holding that it was the guardian's "fail[ure] to use her best skill and labor for the benefit of the beneficiary," and not simply the fact that guardian was also a beneficiary of the estate, that "must not [be] permit[ed]").

Although the State accurately quoted *Edmonds v. John L. Scott Real Estate, Inc.*, 87 Wn. App. 834, 851, 942 P.2d 1072 (1997), it mischaracterized that decision as holding that the mere existence of "a conflict [of interest] in the context of a fiduciary duty violates the CPA." CP 660. Instead, the relevant part of that decision stands for the proposition that "<u>actions</u> . . . inconsistent with the [fiduciary] duties imposed upon one" violate the CPA. *Edmonds*, 87 Wn. App. at 851 (emphasis added). Since the trial court did not find any particular actions by Kaiser in his capacity as trustee that violated his fiduciary duties, it erred as a matter of law in concluding that he violated the CPA simply on account of his assuming the dual status of trustee and beneficiary.[32]

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[31] *See also* George G. Bogart, *The Law of Trusts and Trustees* (2nd Ed., 1993), § 543U, p. 428 (noting that "[a]n express grant of authority to a trustee to perform acts which would otherwise be disloyal has been held to be effective in a number of cases"). The Land Trust Agreement, Assignment of Beneficial Interest, and Agreement and Instructions on which the State relied at summary judgment were all executed the same day. CP 370-87 (all bear the date September 12, 2005). Together, the documents evidence the settlor's agreement that Kaiser could perform acts that might otherwise be disloyal.

[32] Put another way, a CPA violation presumes an unfair or deceptive "act or practice." *RCW 19.86.020*. Simply being both a trustee and a beneficiary, and therefore being exposed to potential conflicts of interest, is not an "act or practice." The State clearly believes that Kaiser's procurement of the partial interest deals was unfair or deceptive,

12. <u>The trial court erred as a matter of law when allowing participants in partial interest deals to repudiate their signatures on written deeds and disclaimers</u>

Under Washington law, "a party whose rights rest upon a written instrument which is plain and unambiguous, and who has read or had the opportunity to read the instrument, cannot claim to have been misled concerning its contents or to be ignorant of what is provided therein." *Nat'l Bank of Wash.,* 81 Wn.2d at 913. Similarly, when there is a dispute about whether a real property transaction is a sale or a loan, courts have held that if "property is conveyed by deed absolute in form, a party attempting to overcome the presumption that the transaction is what it appears to be on its face must do so by clear and convincing evidence." *Gossett v. Farmers Ins. Co. of Washington*, 133 Wn.2d 954, 973, 948 P.2d 1264 (1997).

At the trial of this matter, the state called witnesses from four families to testify about the partial interest deals. RP (12/8/2008) and (12/9/2008). Members of each of these families had signed deeds and other documents describing the nature of the transaction in detail, and stating specifically that the transaction was not a loan. Ex. 1, p. 20 (Metheny); Ex. 2, p. 20 (Villalon); Ex. 3, p. 19 (Dane); Ex. 8, p. 11 (Reynolds). Nonetheless, all of these witnesses claimed that they understood the transaction to be a loan. RP (12/8/2008), pp. 38-39

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but any such unfairness or deception—assuming *arguendo* that it exists—would not support a separate claim of CPA violations based on a breach of fiduciary duties. That would be double-counting. Cf. CP 2212, ¶ 2 and ¶ 5 (assigning separate penalties for creation of partial interest deals and for breaching fiduciary duties as trustees in such deals).

(Dane); RP (12/8/2008), p. 56, lns. 7-9 (Metheny)[33], RP (12/09/2008), p. 103, lns. 13-15 (Reynolds); and RP (12/09/2008), pp. 148-49 (Villalon). The trial court clearly accepted this testimony, and incorporated it into its findings. CP 1278, ¶¶ 13-14 (FOF/COL Nos. 13 and 14).

Kaiser understands that this Court will not second-guess the trial court's decisions about witness credibility. However, the partial interest deal witnesses all at least had the opportunity to read the documents they signed. RP (12/08/2008), p. 40, lns. 8-9 (Dane "vaguely" read documents); RP (12/08/2008), p. 73, lns. 16-18 (Metheny); RP (12/09/2008, morning) p. 114, lns. 18-25 and p. 115, lns. 1-9 (Reynolds); and RP (12/09/2008, morning), p. 145, lns. 15-18 (Villalon). In light of *Nat'l Bank of Wash.*, the trial court could only properly consider the testimony that these witnesses were ignorant about their contracts' terms or misled about their contents if it had previously determined that their contracts were ambiguous. And it should have accepted their characterizations of the transactions as loans only on the basis of clear and compelling evidence. *Gossett*, 133 Wn.2d at 973.

Whether a written instrument is ambiguous is a question of law. *Carlstrom v. Hanline*, 98 Wn. App. 780, 784, 990 P.2d 986 (Div. 1 2000). An ambiguity will not be read into a contract when "it can reasonably be avoided by reading the contract as a whole. *McGary v. Westlake Investors*, 99 Wn.2d 280, 285, 661 P.2d 971 (1983). Here, the trial court

[33] But see RP (12/08/08), p. 63, ln. 10-11 (Metheny stating that "I know that it wasn't a loan")

did not explicitly conclude that the partial interest contracts were ambiguous. *Cf.* CP 1276-81. Even if it is deemed to have reached that conclusion, this Court may review it *de novo*. Such a review will show that conclusion to be erroneous. *See* Ex.1, pp. 2-28, Ex. 2, pp. 1-18, 20-23, Ex. 3, pp. 3-24. As a consequence, the trial court also erred by making factual findings based on testimony that should not have been given weight as a matter of law, and by drawing legal conclusions based on such findings. CP 1278, ¶¶ 13, 14, 18, 23.

13. <u>The trial court erred as a matter of law in concluding that the partial interest deals were unfair</u>

As the State repeatedly emphasized during trial, participants in Kaiser's partial interest deals typically turned to him on the verge of a tax sale, days or sometimes even just hours before their homes would be lost. Because of the looming tax foreclosure sales, the homeowners effectively faced the choice of dealing with Kaiser or having their homes sold for taxes. The State argued, and the trial court agreed, that Kaiser unfairly exploited this situation to the detriment of the homeowners. CP 1278, ¶ 12 (FOF/COL 12), CP 1280, ¶ 21 (FOF/COL 21), CP 1281, ¶ 23 (FOF/COL 23). Neither the State nor the trial court, however, properly framed the issue of the alleged unfairness of the partial interest deals.

In particular, because the alternative to dealing with Kaiser was having their homes sold at a tax auction, this is the relevant comparison for any evaluation of fairness.[34] Although they would be entitled to any overage resulting from the tax sale, no particular overage was guaranteed. Moreover, as a consequence of the tax sale, the homeowners would very likely be immediately evicted.

By contrast, participants in partial interest deals retained a beneficial interest in 50 to 75 percent of the equity in the home (compared with a zero retained interest if the home had been sold at a tax sale). Ex. 1, p. 24; Ex. 2, p. 17; Ex. 3, p. 24. Moreover, they retained this interest at a time of generally rising property values, allowing them to participate in their properties' appreciation. Most importantly, they obtained the right to live in the home for one to three years, prior to it being put on the market, in exchange for paying nominal rent (compared with the very high likelihood of immediate eviction in the event of a tax sale). RP (12/08/2008), p. 42, ln. 24 – p. 43, ln. 1. Thus properly framed as the choice between obtaining an uncertain overage and being immediately evicted, on the one hand, and retaining a 50 to 75% beneficial interest in the property, plus a right to remain in residence for one to three years in exchange for a nominal rent, on the other, it is clear that many "fully informed person[s]" would reasonably opt for the second alternative. RP (1/12/2009) (testimony of Waddell and McIntire); RP (1/13/2009), p. 336, ln. 11 – p. 338, ln. 21. *Cf.* CP 1278, ¶ 12.[35]

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[34] There is only a remote possibility that some other third party might have been able to strike a deal with the homeowners prior to the foreclosure sale.

[35] To the extent Paragraph 12 of the Findings and Conclusions represents a finding of fact, the Kaisers submit that it is not supported by substantial evidence. To the extent that it represents a conclusion of law, the Kaisers submit that it is erroneous.

Kaiser anticipates that the State will claim this argument overlooks that the participants in the partial interest deals were "acting under compulsion" or "in financial distress." CP 1278, ¶ 12; CP 1280, ¶ 21(b). However, the State did not allege, and the trial court did not find, that Kaiser created the relevant compulsion or financial distress. As previously noted, Washington law rejects the proposition that an inequality in bargaining power suffices to make a trade unfair, regardless of whether it was otherwise freely chosen. *Supra*, p. 27 and note 18. To conclude otherwise would actually be antithetical to the beneficial purposes of the CPA, because doing so would curtail the options of those most in need of having more choices. *Cf.* RCW 19.86.920. The trial court erred as a matter of law in concluding that Kaiser's partial interest transactions were "grossly unfair." CP 1280, ¶ 21.

14. <u>The trial court failed to make findings regarding the public interest element in connection with the "four other deals" discussed in the Findings and Conclusions</u>

The trial court also found that "four other deals by Kaiser" were "unfair and deceptive in violation of the Consumer Protection Act." CP 1281 at ¶ 24. Although the court discussed these four deals in some detail in the subsequent paragraphs of its findings and conclusions, it did not find that any of these deals, or all of them together, affected the public interest. *Cf.* CP 1281 – 1283. Nor does the finding in paragraph 22, which refers explicitly to "acts enumerated <u>above</u>," apply to the "four other deals." CP 1281, ¶ 22 (emphasis added). Moreover, the trial court's oral ruling on January 14, 2009 did not refer to the four deals when it discussed the public interest impact of Kaiser's "partial interest transactions." RP (January 14, 2009), p. 9, lns. 9-18.

"It is error not to make findings of fact on all material issues." *Howell v. Kraft*, 10 Wn. App. 266, 271, 517 P.2d 203 (Div. 3 1974) (discussing elements of common-law fraud). *See also State v. Greco*, 57 Wn. App. 196, 204-205, 787 P.2d 940 (1990) (criminal bribery matter); *and Stieneki*, 145 Wn. App. at 565 (civil action alleging breach of contract and fraud). Although in the absence of a written finding by the trial court, the appellate court may look to the oral opinion, in this instance the oral opinion is unhelpful. *Cf. Robel v. Roundup Corporation*, 148 Wn.2d 35, 48 n. 5, 59 P.3d 611 (2003). Remand is necessary for entry of findings regarding the public interest element for each of the four "other deals."

15. Errors in the trial court's determinations on summary judgment and in its Findings and Conclusions require vacation or revision of the remedies imposed

Because of the errors in the Court's Order on Summary Judgment and its Findings and Conclusions, its orders granting injunctive relief, imposing penalties and restitution, and awarding attorneys fees must be vacated or revised on remand. Because claiming tax overages generated on properties Kaiser purchased in fee simple does not violate RCW 84.64.080, and because Kaiser's "overage plays" are not otherwise in violation of the CPA, it was improper to enjoin Kaiser from participating in such transactions (CP 1287, ¶ 3[36]), to penalize him for doing so (CP

[36] Paragraph 3 of the Order on Motion for Injunctive Relief also effectively prevents Kaiser from charging a contingent fee to persons who might be entitled to an overage in

2212, ¶ 1), or to require him to pay restitution (CP 2214, lns 1-3). Similarly, to the extent the trial court erred in determining that certain of Kaiser's other activities violated the CPA, the trial court could not properly enjoin or penalize those purported violations. Finally, the State should not receive attorney's fees for its efforts on issues where the judgment in its favor is overturned by this Court. On remand, the trial court must revisit each of its previous orders entered in the remedies phase of the proceedings.

16. <u>Kaiser requests his attorney's fees on appeal pursuant to RAP 18.1(b) and RCW 19.86.080(1)</u>

In the event that Kaiser is the substantially prevailing party before this Court, he requests that it award him his costs and reasonable attorneys fees incurred on appeal. RCW 19.86.080(1) and states in pertinent part as follows:

> The attorney general may bring an action in the name of the state . . . against any person to restrain and prevent the doing of any act herein prohibited, or declared to be unlawful; and the prevailing party may, in the discretion of the court, recover the costs of said action including a reasonable attorney's fee.

RCW 19.86.080. This Court has the discretion to award fees to Kaiser if he prevails, and should do so to uphold the principle that "vindicated defendants should be treated fairly." *State v. Black*, 100 Wn.2d 793, 806, 676 P.2d 963 (1984) (noting that "small businessmen may be forced into

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return for helping them claim it. Because the propriety of such transactions was never separately addressed at trial, it was error to draft injunctive relief so broadly as to include them.

bankruptcy to defend what may turn out to be legitimate business practices"). In the alternative, this Court may remand to the trial court to determine whether a balancing of relevant factors requires an award of fees to Kaiser. *State v. State Credit Ass'n., Inc.*, 33 Wn. App. 617,628-29, 657 P.2d 327 (Div. 1 1983).

VI. CONCLUSION

Over the many years in which Joseph Kaiser has been investing in real estate, he has never forced anyone to deal with him. Whether Kaiser was buying properties outright or structuring partial interest deals, he only dealt with people who had decided that he was their best option. His actions in purchasing properties and then letting them go to foreclosure sale did not violate RCW 84.64.080, nor were they otherwise deceptive, unfair or unconscionable. At the very least, there are material questions of fact on these issues that prevent summary judgment. Similarly, there are at least material questions of fact that bar summary judgment on the other issues addressed by the State's motion. Moreover, for the reasons spelled out above in detail, the trial court committed several errors of law in drawing its conclusions at the end of trial. Accordingly, this Court should reverse the trial court, vacate the judgment, and remand this matter for further proceedings.

Respectfully submitted this 30th day of November, 2009.

David Corbett PLLC
By: ______________________
David J. Corbett, WSBA # 30895
Attorney for Appellants

CERTIFICATE OF SERVICE

I certify under penalty of perjury of the laws of the State of Washington that on November 30, 2009 I sent a copy of the attached Opening Brief of Appellants ("Opening Brief") via email PDF attachment to Assistant Attorney General James Sugarman, attorney for Respondent, at JamesS6@ATG.WA.GOV. Mr. Sugarman has agreed to accept service of pleadings in this matter via email. I also deposited the Opening Brief with the United States Post Office in Tacoma, postage pre-paid, for delivery by Express Mail to:

James T. Sugarman and Jason E. Bernstein
Assistant Attorneys General
Consumer Protection Division
Attorney General of Washington
800 5th Ave., Suite 2000
Seattle, WA 98104-3188

Dated this 30th day of November, 2009 at Tacoma, Washington.

By: ______________________
David J. Corbett

APPENDIX A

PRICE THEORY AND APPLICATIONS

Decisions, Markets, and Information

SEVENTH EDITION

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Market share by group size, medical practice

Group size	1965	1969	1975	1980
1–2	84.69%	78.25%	68.67%	67.45%
3–7	8.37%	11.53%	13.31%	13.14%
8–25	4.30%	5.09%	8.53%	7.78%
26–99	1.33%	3.00%	5.08%	4.66%
100+	1.31%	2.12%	4.42%	6.97%
Total	100%	100%	100%	100%

Sources: Frech and Ginsberg, p. 30; Marder and Zuckerman, p. 167.

The data in the table can be interpreted quite differently, depending on whether a *static* or *dynamic* viewpoint is adopted. From the static point of view, even in 1980 most of the market consisted of single-physician or two-physician groups. This suggests that small size must indeed be the most efficient in medical practice. On the other hand, these sizes declined relative to all others. So it appears that, *on the margin*, larger firms have been more profitable. New entrants have found it profitable to form larger groups, whereas exiting firms have come disproportionately from the one-to-two-physician category.

A possible explanation is that in any period there is an efficient *mixture* of firm sizes. Even though one-physician and two-physician firms may on the whole be most efficient, in recent years there may have been relatively too many firms of these sizes. So market shares have shifted in favor of the larger groups.

[a] H. E. Frech III and P. Ginsberg, "Optimal Scale in Medical Practice: A Survivor Analysis," *Journal of Business*, v. 47 (January 1974), p. 30.

[b] William D. Marder and Stephan Zuckerman, "Competition and Medical Groups: A Survivor Analysis," *Journal of Health Economics*, v. 4 (June 1985), p. 167.

7.3 THE BENEFITS OF EXCHANGE: CONSUMER SURPLUS AND PRODUCER SURPLUS

One of the most important principles of economics is *The Fundamental Theorem of Exchange*:

PROPOSITION: Trade is mutually beneficial.

Voluntary exchange benefits all parties involved. An alternative, mistaken view might be called "the exploitation theory" – the idea that what one side gains in exchange is a loss to the other side. The proof of the Fundamental Theorem of Exchange, and disproof of the exploitation theory, is elementary. In voluntary exchange between rational persons, both sides must expect to gain. True, owing to mistakes or trickery, one or both participants might lose out. However, if beliefs are not systematically mistaken, the proposition remains true.

But *how much* does each side gain from trade? As explained in Chapter 3, economists do not generally believe it possible to compare one person's utility with another person's. So it would be helpful to have a way of measuring the benefits of trade in objective units, independent of subjective utilities. Consumer Surplus and Producer Surplus are such measures. In Figure 7.7 the market supply-demand equilibrium is at price P^*

The Fundamental Theorem of Exchange – that buyers and sellers both gain from trade – was introduced in Chapter 7. Many economic fallacies, for example, the most common arguments for protective tariffs, overlook the point that voluntary trade benefits both sides.

Still, some objections might be raised. Suppose a buyer paid good money for a beachfront lot that proves to be miles out to sea. The answer is that the parties here did not truly agree on an exchange. Owing to trickery, there was no "meeting of the minds." Another problem: a momentary want may misrepresent a person's true preferences. Esau sold his birthright to Jacob for a mess of pottage (*Genesis*, Chapter 25) and regretted the transaction afterward. Third and most serious, many of us would be better off not satisfying even our most intense desires. Think of a drug addict. Getting what you wish for is often the worst thing that could happen to you. Still, it can always be said that rational participants in voluntary exchange *believe* they will both gain.

Mutual gain from trade involves two distinct elements. The first is an improved (mutually preferred) *allocation of consumption goods.* Suppose Ida and John are endowed with equal quantities of tea and coffee, but Ida prefers tea and John prefers coffee. The potential gain from trade is obvious. Alternatively, suppose Ida and John both prefer bread with butter, but Ida is initially endowed with all the bread and John with all the butter. Again, both can benefit from trade.

The second source of mutual gain is *rearrangement of production.* If Ida is better at baking bread and John at churning butter, trade permits each to concentrate on his or her area of superiority.

CONCLUSION

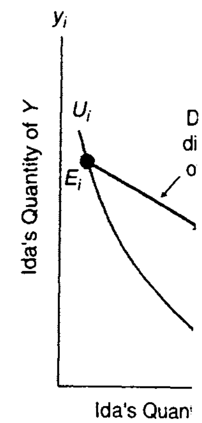
Voluntary exchange is mutually beneficial because (1) Each person obtains a consumption basket he or she prefers to the original endowment. (2) People can specialize in production, thereby increasing the totals of goods available.

This chapter will probe more deeply into these gains from exchange. It will also deal with *transaction costs* that limit the benefits from trade, and with money as a way of minimizing transaction costs. Later on the discussion will follow up a topic introduced in Chapter 11 – asymmetrical information in exchange. An important trade mechanism, auctions, for which asymmetrical information plays a crucial role, will then be analyzed.

14.1 PURE EXCHANGE: THE EDGEWORTH BOX

The first benefit of trade is that, through exchange, people can obtain baskets of goods that better match everyone's desires.

In the mid-1800s, the United States exported wheat to Britain in exchange for manufactured goods. Using the notation X for manufactures and Y for wheat, typical citizens of the two countries are pictured in Figure 14.1. In Panel (a) Ida, the American, has an endowment at position E_i near the vertical axis. (She starts with a relatively large amount of wheat Y.) Panel (b) shows that John, the Briton, has an endowment at E_j, near the horizontal axis. (He starts with a relatively large amount of manufactures X.) The bold lines indicate the desired directions of exchange. If Ida moves down and to the right (giving up wheat for manufactures) while John moves up and to the left (giving up manufactures for wheat), each can attain a higher indifference curve.



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APPENDIX B

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MISTAKE, DISCLOSURE, INFORMATION, AND THE LAW OF CONTRACTS*

*ANTHONY T. KRONMAN***

"[The greater part of the writers on natural law] are of opinion, that the good faith which ought to govern the contract of sale, only requires that the vendor should represent the thing sold as it is, without dissimulating its defects, and not to sell it above the price which it bears at the time of the contract; that he commits no injustice in selling it at this price, although he knows that the price must soon fall; that he is not obliged to disclose to the vendee a knowledge which he may have of the circumstances that may produce a depression of the price; the vendee having no more right to demand that the vendor should impart this knowledge than that he should give away his property. . ."

Pothier, *Traité du Contract de Vente****

Introduction

THIS paper attempts to explain an apparent inconsistency in the law of contracts. On the one hand, there are many contract cases—generally classified under the rubric of unilateral mistake—which hold that a promisor is excused from his obligation to either perform or pay damages when he is mistaken about some important fact and his error is known (or should be known) to the other party. On the other hand, cases may also be found which state that in some circumstances one party to a contract is entitled to withhold information he knows the other party lacks. These latter cases typically rest upon the proposition that the party with knowledge does not owe the other party a "duty of disclosure."

Although these two lines of cases employ different doctrinal techniques, they both address essentially the same question: if one party to a contract knows or has reason to know that the other party is mistaken about a

* I would like to thank Gerhard Casper, Richard Epstein, Walter Hellerstein, Thomas Jackson, Edmund Kitch, William Landes, Richard Posner, George Priest, and George Stigler for their helpful comments on an earlier draft of this paper. Work on this paper was made possible by a grant from the Charles R. Walgreen Foundation.

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*** As quoted in Laidlaw v. Organ, 15 U.S. (2 Wheat.) 187-88, note b.

particular fact, does the knowledgeable party have a duty to speak up or may he remain silent and capitalize on the other party's error? The aim of this paper is to provide a theory which will explain why some contract cases impose such a duty and others do not.

The paper is divided into three parts. In the first part, I discuss the problem of unilateral mistake and offer an economic justification for the rule that a unilaterally mistaken promisor is excused when his error is known or should be known to the other party. In the second part of the paper, I propose a distinction between two kinds of information—information which is the result of a deliberate search and information which has been casually acquired. I argue that a legal privilege of nondisclosure is in effect a property right and attempt to show that where special knowledge or information is the fruit of a deliberate search the assignment of a property right of this sort is required in order to insure production of the information at a socially desirable level. I then attempt to show that a distinction between deliberately and casually accquired information is useful in explaining why disclosure is required in some contract cases but not in others.

In the third, and concluding, part of the paper, I return briefly to the problem of unilateral mistake, in order to reconcile the apparent conflict between the two lines of cases described above. I argue that this apparent conflict disappears when the unilateral mistake cases are viewed from the perspective developed in the second part of the paper.

I. Mistake and the Allocation of Risk.

Every contractual agreement is predicated upon a number of factual assumptions about the world. Some of these assumptions are shared by the parties to the contract and some are not. It is always possible that a particular factual assumption is mistaken.[1] From an economic point of view, the risk of such a mistake (whether it be the mistake of only one party or both) represents a cost.[2] It is a cost to the contracting parties themselves and to

[1] In a strictly economic sense, not all predictive errors are mistakes. An individual may fail to correctly predict a particular outcome merely because his knowledge of the world is incomplete. But unless it would be cost-justified for him to reduce the incompleteness of his knowledge by acquiring new information about the world, it would be incorrect—from an economic point of view—to regard a predictive error of this sort as a genuine mistake. An economist would be likely to define a mistake as an error in prediction resulting from a state of uncertainty which the mistaken party himself would agree could have been cured at a reasonable cost (by augmenting his knowledge of the world). In ordinary parlance, however, the term "mistake" is often used in a much broader sense to mean simply an error which would not have been made if the mistaken party's knowledge of the world had been more complete. It is in this ordinary sense that I use the term here.

[2] Traditionally, academic writers have urged that a variety of different factors be considered in deciding when to excuse a mistaken promisor. The following have been thought especially important: 1) the "nature" of the mistake: Samuel Williston, 13 A Treatise on the Law of

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society as a whole since the actual occurrence of a mistake always (potentially) increases the resources which must be devoted to the process of allocating goods to their highest-valuing users.

There are basically two ways in which this particular cost can be reduced to an optimal level. First, one or both of the parties can take steps to prevent the mistake from occurring. Second, to the extent a mistake cannot be prevented, either party (or both) can insure against the risk of its occurrence

Contracts §§ 1544, 1569, 1570 (3d ed. 1970 [hereinafter cited as Williston]; Arthur Linton Corbin, 3 Corbin on Contracts § 597 (1960) [hereinafter cited as Corbin]; Restatement of Restitution § 9, comment c, § 16, comment c (1937); Restatement of Contracts § 502 (1932); 2) the likelihood of unjust enrichment if the promise is enforced: James Bradley Thayer, Unilateral Mistake and Unjust Enrichment as a Ground for the Avoidance of Legal Transactions, in Harvard Legal Essays 467-99 (1934); George E. Palmer, Mistake and Unjust Enrichment 8, 53, 96 (1962) [hereinafter cited as Palmer]; 3) the magnitude of the promisor's potential loss: Warren A. Seavey, Problems in Restitution, 7 Okla. L. Rev. 257, 267 (1954); Edward H. Rabin, A Proposed Black-Letter Rule Concerning Mistaken Assumptions in Bargaining Transactions, 45 Tex. L. Rev. 1273, 1288-91 (1967) [hereinafter cited as Rabin]; 4) the difficulty of compensating the promisee for any costs he may have incurred in reliance on the promise: Annot., 59 A.L.R. 809 (1929); Rabin at 1299; and 5) the allocation—to one party or the other—of the risk of the mistake: Rabin at 1292-94; Richard A. Posner, Economic Analysis of Law, 73-74 (2d ed. 1977) [hereinafter cited as Posner].

It has usually been assumed that each of these factors ought to be given some unspecifiable weight in deciding when to excuse a mistaken promisor. See Rabin at 1275. Recent treatments of mistake, however, particularly emphasize the importance of determining which party to the contract bears the risk of the mistake in question. This tendency to emphasize the importance of risk-allocation is quite apparent, for example, in the proposed chapter on mistake in the Second Restatement of Contracts. See Restatement (Second) of Contracts §§ 294-96 and Introductory Note (Tent. Draft No. 10, 1975).

The idea that the law often performs a risk-allocating function is of course not a new one. See Edwin W. Patterson, The Apportionment of Business Risks Through Legal Devices, 24 Colum. L. Rev. 335 (1924). But a growing and increasingly sophisticated literature on the subject has deepened our understanding of the concept of risk and has refined its use as an analytical tool. See, for example, Richard A. Posner & Andrew M. Rosenfield, Impossibility and Related Doctrines in Contract Law: An Economic Analysis, 6 J. Leg. Studies 83 (1977); Stephen S. Ashley, The Economic Implications of the Doctrine of Impossibility, 26 Hastings L. J. 1251 (1975); Paul L. Joskow, Commercial Impossibility, The Uranium Market and the Westinghouse Case, 6 J. Leg. Studies 119 (1977); Posner at 73-74; John P. Brown, Product Liability: The Case of an Asset with a Random Life, 64 Am. Econ. Rev. 149 (1974); Alan Schwartz, Sales Law and Inflations, 50 S. Cal. L. Rev. 1 (1976); Kenneth J. Arrow, Insurance, Risk and Resource Allocation, in Theory of Risk-Bearing (1971). An older, but useful, book is Charles O. Hardy, Risk and Risk-Bearing (1923).

As yet, no one has employed the idea of risk-allocation to give a systematic account of the law of mistake as a whole. Posner and Rosenfield, however, offer such an account of the closely allied problems of impossibility and frustration. A theory of mistake based upon the notion of risk-allocation may easily be constructed by generalizing from what has already been said about these related subjects.

Since it rests upon the principle of efficiency and is inspired by the work of scholars writing in the so-called "law and economics" field, I often characterize the point of view adopted in this paper as the "economic" point of view. There is, of course, much more to the economic theory of law in general and contract law in particular than the notion of risk-allocation. See, for example, Posner at 65-69, and Richard A. Posner, Gratuitous Promises in Economics and Law, 6 J. Leg. Studies 411 (1977).

by purchasing insurance from a professional insurer or by self-insuring.[3]

In what follows, I shall be concerned exclusively with the prevention of mistakes. Although this limitation might appear arbitrary, it is warranted by the fact that most mistake cases involve errors which can be prevented at a reasonable cost. Where a risk cannot be prevented at a reasonable cost—which is true of many of the risks associated with what the law calls "supervening impossibilities"—insurance is the only effective means of risk reduction. (This is why the concept of insurance unavoidably plays a more prominent role in the treatment of impossibility than it does in the analysis of mistake.)[4]

Information is the antidote to mistake. Although information is costly to produce,[5] one individual may be able to obtain relevant information more cheaply than another. If the parties to a contract are acting rationally, they will minimize the joint costs of a potential mistake by assigning the risk of its occurrence to the party who is the better (cheaper) information-gatherer. Where the parties have actually assigned the risk—whether explicitly, or implicitly through their adherence to trade custom and past patterns of dealing—their own allocation must be respected.[6] Where they have not—and there is a resulting gap in the contract[7]—a court concerned with economic efficiency should impose the risk on the better information-gatherer. This is so for familiar reasons: by allocating the risk in this way, an

[3] Posner, *supra* note 2, at 74-79; Richard A. Posner & Andrew M. Rosenfield, *supra* note 2.

[4] Many of the events which constitute supervening impossibilities cannot be prevented at a reasonable cost by either contracting party. For example, it is impossible to prevent the outbreak of war (Paradine v. Jane, 82 Eng. Rep. 897 (K.B., 1647), Société Franco Tunisienne d'Armement v. Sidermar S.P.A., [1961] 2 Q.B. 278), a crop failure (Howell v. Coupland, [1874] 9 Q.B. 462, Anderson v. May, 50 Minn. 280, 52 N.W. 530 (1892)), the establishment of a government regulation (Lloyd v. Murphy, 25 Cal. 2d 48, 153 P.2d 47 (1944)), or the cancellation of a coronation parade (Krell v. Henry, [1903] 2 K.B. 740 (C.A.)). Where an event cannot be prevented from occurring, the risk of its occurrence can be effectively reduced only through insurance. This is the principal reason why insurance plays a more important role in impossibility cases than it does in dealing with mistake. Richard A. Posner & Andrew M. Rosenfield, *supra* note 2, at 91.

[5] George J. Stigler, The Economics of Information, 69 J. Pol. Econ. 213 (1961), reprinted in The Organization of Industry 171 (1968).

[6] For a discussion of the way in which trade customs may affect the allocation of risk, see Harold J. Berman, Excuse for Nonperformance in the Light of Contract Practices in International Trade, 63 Colum. L. Rev. 1413 (1963), and Note, Custom and Trade Usages: Its Application to Commercial Dealings and the Common Law, 55 Colum. L. Rev. 1192 (1955).

[7] Whether such a gap exists will depend upon the intentions of the parties as reconstructed by a process of judicial interpretation. The fact that a contract does not cover a particular point explicitly does not mean that the parties failed to reach an understanding with respect to the point in question. Only if no such understanding exists can the contract be said to contain a genuine gap or lacuna. The difficult problems of interpretation which are involved in identifying and then filling gaps are explored in two articles by Professor Farnsworth. See E. Allen Farnsworth, "Meaning" in the Law of Contracts, 76 Yale L.J. 939 (1967), and *id.*, Disputes Over Omissions in Contracts, 68 Colum. L. Rev. 860 (1968).

efficiency-minded court reduces the transaction costs of the contracting process itself.[8]

The most important doctrinal distinction in the law of mistake is the one drawn between "mutual" and "unilateral" mistakes. Traditionally, courts have been more reluctant to excuse a mistaken promisor where he alone is mistaken than where the other party is mistaken as to the same fact.[9] Although relief for unilateral mistake has been liberalized during the last half-century[10] (to the point where some commentators have questioned the utility of the distinction between unilateral and mutual mistake and a few have even urged its abolition),[11] it is still "black-letter" law that a promisor whose mistake is not shared by the other party is less likely to be relieved of his duty to perform than a promisor whose mistake happens to be mutual.[12]

Viewed broadly, the distinction between mutual and unilateral mistake makes sense from an economic point of view. Where both parties to a contract are mistaken about the same fact or state of affairs, deciding which of them would have been better able to prevent the mistake may well require a detailed inquiry regarding the nature of the mistake and the (economic) role or position of each of the parties involved.[13] But where only one party is mistaken, it is reasonable to assume that he is in a better position than the other party to prevent his own error. As we shall see, this is not true in every case, but it provides a useful beginning point for analysis and helps to explain the generic difference between mutual and unilateral mistakes.

The case of *Bowser v. Hamilton Glass Co.*[14] provides a simple illustration. In *Bowser*, the plaintiff was a contractor working on a government project. He solicited bids from subcontractors for the production, among other things, of "variable reflector glasses." In response to the solicitation, the defendant submitted a bid of $.22 each for 1,400 glasses. The plaintiff sent the defendant a formal "purchase order," which constituted his offer to enter a binding contract. Detailed specifications and blueprints were attached to the purchase order. The defendant acknowledged receipt of the purchase

[8] Posner, *supra* note 2, at 74-79; Richard A. Posner & Andrew M. Rosenfield, *supra* note 2, at 88-89.

[9] Restatement (Second) of Contracts, § 295, Comment A (Tent. Draft No. 10, 1975).

[10] *Id.*

[11] 3 Corbin, *supra* note 2, at § 608; Palmer, *supra* note 2, at 67, 96-98; Rabin, *supra* note 2, at 1277-79.

[12] Although it liberalizes relief for unilateral mistake, the Second Restatement of Contracts preserves the basic doctrinal distinction between unilateral and mutual mistake, and makes relief less freely available in the former case than in the latter. In this regard, compare Restatement (Second) of Contracts, §§ 294-95 (Tent. Draft No. 10, 1975) with Restatement of Contracts §§ 502-03 (1932).

[13] Professor Posner's discussion of Sherwood v. Walker illustrates this point. See Posner, *supra* note 2.

[14] 207 F.2d 341 (7th Cir. 1953).

order and produced the glasses. Upon learning that the finished glasses did not conform to the contract specifications, the defendant informed the plaintiff that it would "cancel" the agreement. The plaintiff obtained the glasses from another manufacturer and sued to recover the difference between what it eventually had to pay for them and what it had agreed to pay the defendant. The defendant asserted that it had been mistaken as to the nature of the goods to be produced. The court, in holding for the plaintiff, said that the defendant's mistake did not justify relief, asserting that a unilateral mistake will excuse only where it is known to the other party.

Clearly, the result in *Bowser* makes economic sense. The defendant was in the best position to guard against his own mistake by carefully reading the specifications and examining the blueprints. Although the plaintiff could have prevented the mistake by acquiring the necessary expertise himself, by supervising the defendant's own initial reading of the proposed contract, and by periodically checking to make sure that the produced goods conformed to the contract specifications, it would have been very expensive for him to do so. The joint costs of an error of this sort are minimized by putting the risk of the mistake on the mistaken party. This is the solution the parties themselves would have agreed to if they had been made aware of the risk at the time the contract was formed. It is also the solution which is optimal from a social point of view.

In the past, it was often asserted that, absent fraud or misrepresentation, a unilateral mistake never justifies excusing the mistaken party from his duty to perform or pay damages.[15] This is certainly no longer the law, and Corbin has demonstrated that in all probability it never was.[16] One well-established exception protects the unilaterally mistaken promisor whose error is known or reasonably should be known to the other party.[17] Relief has long been available in this case despite the fact that the promisor's mistake is not shared by the other party to the contract.

For example, if a bidder submits a bid containing a clerical error or miscalculation, and the mistake is either evident on the face of the bid or may reasonably be inferred from a discrepancy between it and other bids, the bidder will typically be permitted to withdraw the bid without having to

[15] 3 Corbin, *supra* note 2, at § 608; Restatement of Contracts § 503 (1932).

[16] 3 Corbin, *supra* note 2, at § 608; "Statements are exceedingly common, both in texts and in court opinions, that relief will not be given on the ground of mistake unless the mistake is 'mutual'. Such a broad generalization is untrue. Seldom is it accompanied by either definition or analysis . . . Cases do not always submit to be classified with either 'mutual mistake' or 'unilateral mistake'. And even when they do submit, the solution does not mechanically follow in accordance with a separate set of rules for each class. Very often relief has been and will be granted where the mistake is unilateral."

[17] 3 Corbin, *supra* note 2, at § 610; Benedict I. Lubell, Unilateral Palpable and Impalpable Mistake in Construction Contracts, 16 Minn. L. Rev. 137 (1932) [hereinafter cited as Lubell]; Rabin, *supra* note 2, at 1279-81.

pay damages (even after the bid has been accepted and in some cases relied upon by the other party).[18] Or, to take another example, suppose that A submits a proposed contract in writing to B and knows that B has misread the document. If B accepts the proposed contract, upon discovering his error, he may avoid his obligations under the contract and has no duty to compensate A for A's lost expectation.[19] A closely related situation involves the offer which is "too good to be true." One receiving such an offer cannot "snap it up"; if he does so, the offeror may withdraw the offer despite the fact that it has been accepted.[20]

In each of the cases just described, one party is mistaken and the other has actual knowledge or reason to know of his mistake. The mistaken party in each case is excused from meeting any contractual obligations owed to the party with knowledge.

A rule of this sort is a sensible one. While it is true that in each of the cases just described the mistaken party is likely to be the one best able to prevent the mistake from occurring in the first place (by exercising care in preparing his bid or in reading the proposed contract which has been submitted to him), the other party may be able to rectify the mistake more cheaply in the interim between its occurrence and the formation of the contract. At one moment in time the mistaken party is the better mistake-preventer (information-gatherer). At some subsequent moment, however, the other

[18] "Suppose, first, a case in which a bidding contractor makes an offer to supply specified goods or to do specified work for a definitely named price, and that he was caused to name this price by an antecedent error of computation. If, before acceptance, the offeree knows, or has reason to know, that a material error has been made, he is seldom mean enough to accept; and if he does accept, the courts have no difficulty in throwing him out. He is not permitted 'to snap up' such an offer and profit thereby." 3 Corbin, *supra* note 2, at § 609. For a case in which a bidding contractor was permitted to withdraw his bid despite acceptance *and reliance* by the party to whom it was submitted, see Union Tank Car Co. v. Wheat Brothers, 15 Utah 2d 101, 387 P.2d 1000 (1964).

It would be irrational from an economic point of view to permit the party with knowledge (or reason to know) of the mistake to enforce the other party's promise on reliance grounds. A rule of this sort would encourage reliance precisely where it ought to be discouraged.

If the non-mistaken party has *no reason to know* of the error, however, the extent of his reliance is often a factor in determining the damages to which he is entitled. If he has substantially relied on the mistaken party's promise, the non-mistaken party will usually be given the right to enforce the contract (by suing to recover his lost expectation). If, on the other hand, the non-mistaken party has not substantially relied on the promise before the error is discovered, courts will often allow the mistaken party to withdraw from the contract on the condition that he compensate the non-mistaken party for any reliance expenses or incidental costs he has incurred (such as having to solicit new bids).

[19] 3 Corbin, *supra* note 2, at § 607; Williston, *supra* note 2, at § 1577. See also Restatement of Contracts § 505, Comment A (1932) (dealing with the mistaken party's right to have the contract reformed).

[20] 1 Williston, *supra* note 2, at § 94. See Bell v. Carroll, 212 Ky. 231, 278 S.W. 541 (1925), Germain Fruit Co. v. Western Union Tel Co., 137 Cal. 598, 70 P. 658 (1902), United States v. Braunstein, 75 F. Supp. 137 (S.D.N.Y. 1947).

party may be the better preventer because of his superior access to relevant information that will disclose the mistake and thus allow its correction. This may be so, for example, if he has other bids to compare with the mistaken one since this will provide him with information which the bidder himself lacks.[21] Of course, if the mistake is one which cannot reasonably be known by the non-mistaken party (that is, if he would have to incur substantial costs in order to discover it), there is no reason to assume that the non-mistaken party is the better (more efficient) mistake-preventer at the time the contract is executed. But if the mistake is actually known or could be discovered at a very slight cost, the principle of efficiency is best served by a compound liability rule which imposes initial responsibility for the mistake on the mistaken party but shifts liability to the other party if he has actual knowledge or reason to know of the error. Compound liability rules of this sort are familiar in other areas of the law: the tort doctrine of "last clear chance" is one example.[22]

The cases in which relief is granted to a unilaterally mistaken promisor on the grounds that his mistake was known or reasonably knowable by the other party appear, however, to conflict sharply with another line of cases. These cases deal with the related problems of fraud and disclosure: if one party to a contract knows that the other is mistaken as to some material fact, is it fraud for the party with knowledge to fail to disclose the error and may the mistaken party avoid the contract on the theory that he was owed a duty of disclosure?[23] This question is not always answered in the same way. In some cases, courts typically find a duty to disclose and in others they do not.[24] It is the latter group of cases—those not requiring disclosure—which

[21] See Lubell, *supra* note 17, at 147-54.

[22] See Richard A. Posner, A Theory of Negligence, 1 J. Leg. Studies 29, 58 (1972); Charles O. Gregory, Harry Kalven, Jr., & Richard A. Epstein, Cases and Materials on Torts, 400-06 (3d ed. 1977). It might be argued that a compound liability rule of this sort will encourage the mistaken party to reduce his own initial investment in mistake prevention. This may be true to a limited extent. But since the (potentially) mistaken party has no way of knowing whether any mistake he might make would be known or reasonably knowable by the other party, he takes a substantial risk in reducing the level of his own efforts at mistake prevention. The larger this risk, the smaller his reduction will be. For a general discussion of how liability rules affect individual behavior and accident prevention in the context of a single activity, see Peter A. Diamond, Single Activity Accidents, 3 J. Leg. Studies 107 (1974).

[23] Although the nondisclosure cases are often discussed in connection with the problem of unilateral mistake, the relation between the doctrines of nondisclosure and mistake has frequently puzzled commentators. Thus, in a classic article one commentator writes: "A case of some difficulty arises where the unilateral mistake is known to the other party and he joins in the formation of the contract with the mistake uncorrected. The question of how far he is under a duty to disclose his superior knowledge is determined by principles of the law other than those we have under discussion [that is, the principles of mistake], and where there is such a duty to disclose and failure to observe it, there is generally a case of fraud." Roland R. Foulke, Mistake in the Formation and Performance of a Contract, 11 Colum. L. Rev. 197, 229 (1911). See also Rabin, *supra* note 2, at 1279; Palmer, *supra* note 2, at 80-89.

[24] 12 Williston, *supra* note 2, at §§ 1497-99. See text at notes 49-76 *infra*.

appear to conflict with the rule that a unilateral mistake will excuse if the other party knows or has reason to know of its existence.

In the cases not requiring disclosure, one party is mistaken and the other party knows or has reason to know it. Can these cases be reconciled with those which stand for the proposition that a unilateral mistake plus knowledge or reason to know will excuse the mistaken party? More particularly, can the apparent divergence between these two lines of cases be explained on economic grounds?

The rest of this paper is devoted to answering these two questions. In brief, the answer I propose is as follows. Where nondisclosure is permitted (or put differently, where the knowledgeable party's contract rights are enforced despite his failure to disclose a known mistake), the knowledge involved is typically the product of a costly search. A rule permitting nondisclosure is the only effective way of providing an incentive to invest in the production of such knowledge. By contrast, in the cases requiring disclosure,[25] and in those excusing a unilaterally mistaken promisor because the other party knew or had reason to know of his error, the knowledgeable party's special information is typically not the fruit of a deliberate search. Although information of this sort is socially useful as well, a disclosure requirement will not cause a sharp reduction in the amount of such information which is actually produced. If one takes into account the investment costs incurred in the deliberate production of information, the two apparently divergent lines of cases described above may both be seen as conforming (roughly) to the principle of efficiency, which requires that the risk of a unilateral mistake be placed on the most effective risk-preventer.

II. The Production of Information and the Duty to Disclose

A. *General Considerations*

It is appropriate to begin a discussion of fraud and nondisclosure in contract law with the celebrated case of *Laidlaw v. Organ*.[26] Organ was a New Orleans commission merchant engaged in the purchase and sale of tobacco.

[25] Although throughout the paper I use the expression "duty to disclose," the duty involved is typically not a true legal obligation. If the party with knowledge fails to disclose the other party's error, his failure to do so will give the mistaken party grounds for avoiding any contract which has been concluded between them. In the absence of such a contract, however, the knowing party has no positive duty to disclose—that is, nondisclosure will not by itself give the mistaken party the right to sue him for damages. Of course, in some cases—for example, where there is a fiduciary relation between the parties—a positive duty of this latter sort may exist. Where it does, a failure to disclose is not simply a defense to the knowing party's suit to enforce the other party's contractual obligations; it also provides the mistaken party with an independent cause of action for damages.

[26] Laidlaw v. Organ, 15 U.S. (2 Wheat.) 178.

Early on the morning of February 19, 1815, he was informed by a Mr. Shepherd that a peace treaty had been signed at Ghent by American and British officers, formally ending the War of 1812. Mr. Shepherd (who was himself interested in the profits of the transaction involved in *Laidlaw v. Organ*) had obtained information regarding the treaty from his brother who, along with two other gentlemen, brought the news from the British Fleet. (What Shepherd's brother and his companions were doing with the British Fleet is not disclosed.)

Knowledge of the treaty was made public in a handbill circulated around eight o'clock on the morning of the nineteenth. However, before the treaty's existence had been publicized ("soon after sunrise" according to the reported version of the case), Organ, knowing of the treaty, called on a representative of the Laidlaw firm and entered into a contract for the purchase of 111 hogsheads of tobacco. Before agreeing to sell the tobacco, the Laidlaw representative "asked if there was any news which was calculated to enhance the price or value of the article about to be purchased." It is unclear what response, if any, Organ made to this inquiry.[27]

As a result of the news of the treaty—which signalled an end to the naval blockade of New Orleans—the market price of tobacco quickly rose by 30 to 50 percent. Laidlaw refused to deliver the tobacco as he had originally promised. Organ subsequently brought suit to recover damages and to block Laidlaw from otherwise disposing of the goods in controversy. Although the report of the case is unclear, it appears that the trial judge directed a verdict in Organ's favor. The case was appealed to the United States Supreme Court which in an opinion by Chief Justice Marshall remanded with directions for a new trial. The Court concluded that the question "whether any imposition was practiced by the vendee upon the vendor ought to have been submitted to the jury" and that as a result "the absolute instruction of the judge was erroneous." Marshall's opinion is more famous, however, for its dictum than for its holding:

> The question in this case is, whether the intelligence of extrinsic circumstances, which might influence the price of the commodity, and which was exclusively within the knowledge of the vendee, ought to have been communicated by him to the vendor? The court is of opinion that he was not bound to communicate it. It would be difficult to circumscribe the contrary doctrine within proper limits, where the means of intelligence are equally accessible to both parties. But at the same time, each party must take care not to say or do anything tending to impose upon the other.

[27] If Organ denied that he had heard any news of this sort, he would have committed a fraud. It may even be, in light of Laidlaw's direct question, that silence on Organ's part was fraudulent. William W. Story, A Treatise on the Law of Contracts 444 n.2 (2d ed. 1847). In my discussion of the case, and of the general rule which Marshall lays down in his famous dictum, I have put aside any question of fraud on Organ's part. See note 49 *infra*.

Although Marshall's dictum in *Laidlaw v. Organ* has been sharply criticized,[28] it is still generally regarded as an accurate statement of the law (when properly interpreted).[29] The broad rule which Marshall endorses has usually been justified on three related grounds: that it conforms to the legitimate expectations of commercial parties and thus accurately reflects the (harsh) morality of the marketplace;[30] that in a contract for the sale of goods each party takes the risk that his own evaluation of the worth of the goods may be erroneous;[31] or finally, that it justly rewards the intelligence and industry of the party with special knowledge (in this case, the buyer).[32] This last idea may be elaborated in the following way.

News of the treaty of Ghent affected the price of tobacco in New Orleans. Price measures the relative value of commodities: information regarding the treaty revealed a new state of affairs in which the value of tobacco—relative to other goods and to tobacco-substitutes in particular—had altered.[33] An alteration of this sort is almost certain to affect the allocation of social resources.[34] If the price of tobacco to suppliers rises, for example, farmers will be encouraged to plant more tobacco and tobacco merchants may be prepared to pay more to get their goods to and from market. In this way, the

[28] See, for example, Palmer, *supra* note 2, at 84.

[29] 12 Williston, *supra* note 2, at § 1497; Restatement of Contracts § 472, Comment B (1932); Rabin, *supra* note 2, at 1279; W. Page Keeton, Fraud—Concealment and Non-Disclosure, 15 Tex. L. Rev. 1, 21-23 (1936) [hereinafter cited as Keeton]; Edwin W. Patterson, Essentials of Insurance Law 447 (1957).

[30] Classic statements of this idea may be found in William W. Story, *supra* note 27, at 442-43, and James Kent, 2 Commentaries §§ 484, 485 (12th ed. 1873).

[31] "If in an arm's-length bargaining transaction A has assumed the risk concerning the existence or nonexistence of certain facts, and he is mistaken concerning these facts, and there has been no fraud or imposition, A will not be able to rescind his contract, regardless of B's knowledge of A's mistake" [citing Laidlaw v. Organ, 15 U.S. (2 Wheat.) 178 (1817)]. Rabin, *supra* note 2, at 1279.

[32] In his excellent law review article on fraud and nondisclosure, Professor Keeton draws attention to the fact that courts, in deciding when to impose a duty to disclose special information, have been influenced by the way in which the information was acquired. At one point, for example, he states that "the way in which the buyer acquires the information which he conceals from the vendor should be a material circumstance. The information might have been acquired as a result of his bringing to bear a superior knowledge, intelligence, skill or technical judgment; it might have been acquired by mere chance; or it might have been acquired by means of some tortious action on his part." Keeton, *supra* note 29, at 25. The main purpose of the present article is to develop this distinction between different kinds of information in a more rigorous fashion, to justify the distinction on economic grounds, and to demonstrate its explanatory power as a principle for ordering the disclosure cases.

[33] See generally Jack Hirshleifer, The Private and Social Value of Information and the Reward to Inventive Activity, 61 Am. Econ. Rev. 561 (1977) [hereinafter cited as Hirshleifer].

[34] This will not be true in a regime of "pure exchange," that is, in a regime where goods are only exchanged and not produced (the pool of exchanged goods remaining constant). In "the more realistic regime in which production and exchange both take place," however, information of the sort involved in Laidlaw v. Organ will have allocative consequences. Hirshleifer, *supra* note 33, at 566-67.

proportion of society's (limited) resources devoted to the production and transportation of tobacco will be increased. Information revealing a change in circumstances which alters the relative value of a particular commodity will always have some (perhaps unmeasurable) allocative impact. (In addition, of course, information of this sort will have distributive consequences: the owners of tobacco or of rights to tobacco will be relatively wealthier after the price rise, assuming that other prices have not risen or have not risen as fast.)

From a social point of view, it is desirable that information which reveals a change in circumstances affecting the relative value of commodities reach the market as quickly as possible (or put differently, that the time between the change itself and its comprehension and assessment be minimized).[35] If a farmer who would have planted tobacco had he known of the change plants peanuts instead, he will have to choose between either uprooting one crop and substituting another (which may be prohibitively expensive and will in any case be costly), or devoting his land to a nonoptimal use. In either case, both the individual farmer and society as a whole will be worse off than if he had planted tobacco to begin with. The sooner information of the change reaches the farmer, the less likely it is that social resources will be wasted.

Consider another (and perhaps more realistic) illustration of the same point. *A* is a shipowner who normally transports goods between New Orleans and various other ports. However, because of the naval blockade, he is unable to enter the New Orleans harbor. Some time after the treaty is signed, but before its existence is publicized, *A* enters a contract to ship cotton from Savannah to New York City. After news of the treaty reaches New Orleans, a tobacco merchant in that city offers *A* a "bonus" if he will agree to deliver a shipment of tobacco to Baltimore. If we assume that the offer is sufficiently attractive to induce *A* to breach his first contract and pay damages,[36] although his ship will be properly allocated to its highest-valuing

[35] "To gain an advantage from better knowledge of facilities of communication or transport is sometimes regarded as almost dishonest, although it is quite as important that society make use of the best opportunities in this respect as in using the latest scientific discoveries. This prejudice has in a considerable measure affected the attitude toward commerce in general compared with that toward production. Even economists who regard themselves as definitely above the crude materialist fallacies of the past constantly commit the same mistake where activities directed toward the acquisition of such practical knowledge are concerned—apparently because in their scheme of things all such knowledge is supposed to be 'given'. The common idea now seems to be that all such knowledge should as a matter of course be readily at the command of everybody, and the reproach of irrationality leveled against the existing economic order is frequently based on the fact that it is not so available. This view disregards the fact that the method by which such knowledge can be made as widely available as possible is precisely the problem to which we have to find an answer." F. A. Hayek, The Use of Knowledge in Society, 35 Am. Econ. Rev. 519, 522 (1945).

[36] Which it will be if the new offer is for an amount greater than the old contract plus whatever damages *A* will have to pay *B* for breach of his original promise to carry *B*'s cotton to

user, the cost of allocating it will be greater than it would have been had information of the treaty reached *A* before he entered his first contract. Resources will be consumed by *A* in transacting out of the first contract; from a social point of view, their consumption represents a pure waste.

Allocative efficiency is promoted by getting information of changed circumstances to the market as quickly as possible. Of course, the information doesn't just "get" there. Like everything else, it is supplied by individuals (either directly, by being publicized, or indirectly, when it is signalled by an individual's market behavior).

In some cases, the individuals who supply information have obtained it by a deliberate search; in other cases, their information has been acquired casually.[37] A securities analyst, for example, acquires information about a particular corporation in a deliberate fashion—by carefully studying evidence of its economic performance. By contrast, a businessman who acquires a valuable piece of information when he accidentally overhears a conversation on a bus acquires the information casually.[38]

As it is used here, the term "deliberately acquired information" means information whose acquisition entails costs which would not have been incurred but for the likelihood, however great, that the information in question would actually be produced. These costs may include, of course, not only direct search costs (the cost of examining the corporation's annual statement) but the costs of developing an initial expertise as well (for example, the cost of attending business school). If the costs incurred in acquiring the information (the cost of the bus ticket in the second example) would have been incurred in any case—that is, whether or not the information was forthcoming—the information may be said to have been casually acquired. The distinction between deliberately and casually acquired information is a shorthand way of expressing this economic difference. Although in reality it may be difficult to determine whether any particular item of information has been acquired in one way or the other, the distinction between these two types of information has—as I hope to show—considerable analytical usefulness.

If information has been deliberately acquired (in the sense defined above), and its possessor is denied the benefits of having and using it, he will have an

New York. See John H. Barton, The Economic Basis of Damages for Breach of Contract, 1 J. Leg. Studies 277 (1972); Posner, *supra* note 2, at 88-93.

[37] Compare the distinction between "professional" and "altruistic" rescuers drawn by William M. Landes & Richard A. Posner in Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism, 7 J. Leg. Studies 83 (1978). The costs of searching for information are analyzed in Stigler, The Economics of Information in the Organization of Industry (1968).

[38] Unless, of course, he rides buses for this very purpose. In this improbable case, he would acquire his information deliberately.

incentive to reduce (or curtail entirely) his production of such information in the future. This is in fact merely a consequence of defining deliberately acquired information in the way that I have, since one who acquires information of this sort will by definition have incurred costs which he would have avoided had it not been for the prospect of the benefits he has now been denied. By being denied the same benefits, one who has casually acquired information will not be discouraged from doing what—for independent reasons—he would have done in any case.

It might be claimed that whenever the benefits of possessing any kind of information are either increased or decreased, one would expect to find *some* overall adjustment in the level of investment in the production of such information. If he is not permitted to benefit from the information he acquires, even the bus rider will in the future pay less attention to the conversations going on around him (although it would certainly be strange if he stopped riding buses altogether). But while it is true that in reality every adjustment (upwards or downwards) in the benefits of possessing a particular kind of information will have an incentive effect of some sort, the effect may vary in magnitude—it may be greater or lesser. Strictly speaking, casually acquired information (as I have used the term up to this point) represents the ideal limit of a continuum—the case in which the change in magnitude that results from eliminating one of the benefits of possessing certain information is zero. In any real case there will be incentive effects which fall somewhere along the continuum. However, where the decline in the production of a certain kind of information which is caused by denying its possessor the right to appropriate the information for his own benefit is small, it is likely to be more than offset by the corresponding social gain that results from the avoidance of mistakes. In the argument that follows, I shall use the term "casually acquired information" in a somewhat looser sense than I have used it so far to refer to information of this sort.

One effective way of insuring that an individual will benefit from the possession of information (or anything else for that matter) is to assign him a property right in the information itself—a right or entitlement to invoke the coercive machinery of the state in order to exclude others from its use and enjoyment.[39] The benefits of possession become secure only when the state transforms the possessor of information into an owner by investing him with a legally enforceable property right of some sort or other. The assignment of property rights in information is a familiar feature of our legal system. The legal protection accorded patented inventions and certain trade secrets are two obvious examples.[40]

[39] See Harold Demsetz, Toward a Theory of Property Rights, 57 Am. Econ. Rev. 347 (Papers & Proceedings 1967).

[40] See Arnold Plant, The Economic Theory Concerning Patents for Inventions, in Selected Economic Essays and Addresses 35 (1974).

One (seldom noticed) way in which the legal system can establish property rights in information is by permitting an informed party to enter—and enforce—contracts which his information suggests are profitable, without disclosing the information to the other party.[41] Imposing a duty to disclose upon the knowledgeable party deprives him of a private advantage which the information would otherwise afford. A duty to disclose is tantamount to a requirement that the benefit of the information be publicly shared and is thus antithetical to the notion of a property right which—whatever else it may entail—always requires the legal protection of private appropriation.[42]

Of course, different sorts of property rights may be better suited for protecting possessory interests in different sorts of information.[43] It is unlikely, for example, that information of the kind involved in *Laidlaw v. Organ* could be effectively protected by a patent system.[44] The only feasible way of assigning property rights in short-lived market information is to permit those with such information to contract freely without disclosing what they know.

It is unclear, from the report of the case, whether the buyer in *Laidlaw* casually acquired his information or made a deliberate investment in seeking it out (for example, by cultivating a network of valuable commercial "friendships"). If we assume the buyer casually acquired his knowledge of the treaty, requiring him to disclose the information to his seller (that is, denying him a property right in the information) will have no significant effect on his future behavior. Since one who casually acquires information makes no investment in its acquisition, subjecting him to a duty to disclose is not likely

[41] This notion is suggested—but not developed—by Hirshleifer. In discussing the fate of Eli Whitney, who "invested considerable resources in the attempt to protect his patent and prosecute infringements" (to no avail), Hirshleifer has this to say:

> "But what seems to have been overlooked is that there were other routes to profit for Whitney. The cotton gin had obvious speculative implications for the price of cotton, the value of slaves and of cotton-bearing land, the business prospects of firms engaged in cotton ware-housing and shipping, the site values of key points in the transportation network that sprang up. There were also predictable implications for competitor industries (wool) and complementary ones (textiles, machinery). It seems very likely that some forethoughted individuals reaped speculative gains on these developments, though apparently Whitney did not. And yet, he was the first in the know, the possessor of an unparalleled opportunity for speculative profit. Alternatively, of course, Whitney could have attempted to keep his process secret except to those who bought the information from him."

Hirshleifer, *supra* note 33, at 571.

[42] If one party to a contract is under a duty to disclose, he must speak up whether or not the other party to the contract asks him what he knows. The fact that the knowledgeable party is *not* under a duty of disclosure does not mean, however, that he can lie when asked a question of this sort. That would be fraud. However, the knowledgeable party who is not under such a duty may refuse to respond to the other party's inquiries, and put the other party to the risk of deciding whether to go ahead with the contract or not. (The knowledgeable party may, of course, simply sell his information to the other party if he wishes.)

[43] On the general costs of establishing property rights in information, see Harold Demsetz, Information and Efficiency: Another Viewpoint, 12 J. Law & Econ. 1, 10-11 (1969).

[44] See Arnold Plant, *supra* note 40 for a discussion of the costs of the patent system, as compared with other legal devices for the assignment of property rights in information.

to reduce the amount of socially useful information which he actually generates. Of course, if the buyer in *Laidlaw* acquired his knowledge of the treaty as the result of a deliberate and costly search, a disclosure requirement will deprive him of any private benefit which he might otherwise realize from possession of the information and should discourage him from making similar investments in the future.

In addition, since it would enable the seller to appropriate the buyer's information without cost and would eliminate the danger of his being lured unwittingly into a losing contract by one possessing superior knowledge, a disclosure requirement will also reduce the seller's incentive to search. Denying the buyer a property right in deliberately acquired information will therefore discourage both buyers and sellers from investing in the development of expertise and in the actual search for information. The assignment of such a right will not only protect the investment of the party possessing the special knowledge, it will also impose an opportunity cost on the other party and thus give him an incentive to undertake a (cost-justified) search of his own.

If we assume that courts can easily discriminate between those who have acquired information casually and those who have acquired it deliberately, plausible economic considerations might well justify imposing a duty to disclose on a case-by-case basis (imposing it where the information has been casually acquired, refusing to impose it where the information is the fruit of a deliberate search). A party who has casually acquired information is, at the time of the transaction, likely to be a better (cheaper) mistake-preventer than the mistaken party with whom he deals—regardless of the fact that both parties initially had equal access to the information in question. One who has deliberately acquired information is also in a position to prevent the other party's error. But in determining the cost to the knowledgeable party of preventing the mistake (by disclosure), we must include whatever investment he has made in acquiring the information in the first place. This investment will represent a loss to him if the other party can avoid the contract on the grounds that the party with the information owes him a duty of disclosure.

If we take this cost into account, it is no longer clear that the party with knowledge is the cheaper mistake-preventer when his knowledge has been deliberately acquired. Indeed, the opposite conclusion seems more plausible. In this case, therefore, a rule permitting nondisclosure (which has the effect of imposing the risk of a mistake on the mistaken party) corresponds to the arrangement the parties themselves would have been likely to adopt if they had negotiated an explicit allocation of the risk at the time they entered the contract. The parties to a contract are always free to allocate this particular risk by including an appropriate disclaimer in the terms of their agreement. Where they have failed to do so, however, the object of the law of contracts should be (as it is elsewhere) to reduce transaction costs by

providing a legal rule which approximates the arrangement the parties would have chosen for themselves if they had deliberately addressed the problem.[45] This consideration, coupled with the reduction in the production of socially useful information which is likely to follow from subjecting him to a disclosure requirement, suggests that allocative efficiency is best served by permitting one who possesses deliberately acquired information to enter and enforce favorable bargains without disclosing what he knows.[46]

A rule which calls for case-by-case application of a disclosure requirement is likely, however, to involve factual issues that will be difficult (and expensive) to resolve. *Laidlaw* itself illustrates this point nicely. On the facts of the case, as we have them, it is impossible to determine whether the buyer actually made a deliberate investment in acquiring information regarding the treaty. The cost of administering a disclosure requirement on a case-by-case basis is likely to be substantial.[47]

As an alternative, one might uniformly apply a blanket rule (of disclosure or nondisclosure) across each class of cases involving the same sort of information (for example, information about market conditions or about defects in property held for sale). In determining the appropriate blanket rule for a particular class of cases, it would first be necessary to decide whether the

[45] Posner, *supra* note 2, at 65-69; Richard A. Posner & Andrew M. Rosenfield, *supra* note 2, at 88-89.

[46] In recent years, there has been considerable disagreement among economists regarding the optimal level of private investment in the production of information. This problem has been discussed in Kenneth J. Arrow, Higher Education as a Filter, 2 J. Pub. Econ. 193 (1973); Harold Demsetz, Information and Efficiency: Another Viewpoint, 12 J. Law & Econ. 1 (1969): John M. Marshall, Private Incentives and Public Information, 64 Am. Econ. Rev. 373 (1974); Eugene F. Fama & Arthur B. Laffer, Information and Capital Markets, 44 J. Bus. 289 (1971); Hirshleifer, *supra* note 33; and Yoram Barzel, Some Fallacies in the Interpretation of Information Costs, 20 J. Law & Econ. 291 (1977).

The economists who have discussed the problem agree that under a legal system which recognized no property rights in information, too little information would be produced. Several economists, however, have expressed a concern that a system of property rights in information may, under some circumstances, induce an overinvestment in the production of information. See, for example, Hirshleifer, *supra* note 33, at 573. Assuming that our legal rules cannot be more finely tuned, in deciding whether to permit the nondisclosure of certain information (that is, grant a property right in the information), we may be forced to make a practical choice between over- and underinvestment—between two less-than-optimal alternatives. However, since it is certain that the elimination of property rights will result in underproduction, and merely a danger that the recognition of such rights will lead to overproduction, there is a strong (but not conclusive) economic case for recognizing property rights in information, at least where the information is deliberately acquired. From an economic point of view, this may not be an optimal solution, but it is more attractive than the other (practical) alternative.

[47] For a general discussion of the costs (and benefits) of specificity in the formulation of legal rules, see Isaac Ehrlich & Richard A. Posner, An Economic Analysis of Legal Rulemaking, 3 J. Leg. Studies 257 (1974). One of the disadvantages of a case-by-case approach is that it may encourage information seekers to invest more than they would otherwise invest merely in order to "stake" their proprietary claims. For a discussion of this problem, in the context of water rights, see Jack Hirshleifer, James C. DeHaven, & Jerome W. Milliman, Water Supply: Economics, Technology, and Policy 59-66 (1960).

kind of information involved is (on the whole) more likely to be generated by chance or by deliberate searching. The greater the likelihood that such information will be deliberately produced rather than casually discovered, the more plausible the assumption becomes that a blanket rule permitting nondisclosure will have benefits that outweigh its costs.

In *Laidlaw*, for example, the information involved concerned changing market conditions. The results in that case may be justified (from the more general perspective just described) on the grounds that information regarding the state of the market is typically (although not in every case) the product of a deliberate search. The large number of individuals who are actually engaged in the production of such information lends some empirical support to this proposition.[48]

B. *The Case Law*

The distinction between deliberately and casually acquired information helps us to understand the pattern exhibited by the cases in which a duty to disclose is asserted by one party or the other. By and large, the cases requiring disclosure involve information which is likely to have been casually acquired (in the sense defined above). The cases permitting nondisclosure, on the other hand, involve information which, on the whole, is likely to have been deliberately produced. Taken as a group, the disclosure cases give at least the appearance of promoting allocative efficiency by limiting the assignment of property rights to those types of information which are likely to be the fruit of a deliberate investment (either in the development of expertise or in actual searching).[49]

[48] In its 42nd annual report for the fiscal year ending June 30, 1976, the Securities and Exchange Commission states that at the end of fiscal year 1976 total broker-dealer registrations numbered 5,308 and total investment adviser registrations numbered 3,857; 42 S.E.C. Ann. Rep. 182 (1976). The number of individuals actually engaged in the deliberate collection and dissemination of market information is, of course, much larger than these figures would indicate since a single broker-dealer or investment adviser may well be a large firm with many employees.

[49] I note, before turning to disclosure cases themselves, that many of the cases raise two problems which are not addressed in this paper. The first problem involves the existence or nonexistence of a confidential or fiduciary relation between the parties to the contract. Where such a relation exists, courts are more likely to require disclosure than they would otherwise be. "Where a fiduciary relationship exists between the parties, such as attorney and client, guardian and ward, trustee and *cestui que trust*, executor and legatee, principal and agent, partner and copartners, joint venturer and fellow joint venturers, there is a positive duty to disclose material facts; a failure to do so is constructively fraudulent. As mentioned earlier, a similar obligation exists where a broker dealing in securities or real estate represents a principal.

Also, the nature of the transaction or the relation of the parties may be such that as to the particular transaction in question, the duties of a fiduciary are imposed upon one or the other party, and such a relation involves a duty of disclosure." 12 Williston, *supra* note 2, at § 1499. See also William W. Kerr, Kerr on the Law of Fraud and Mistake 185-86 (7th ed. 1952); George Spencer Bower, Actionable Non-Disclosure 273-74 (1915).

The second problem concerns the line between nondisclosure, on the one hand, and fraud or positive misrepresentation, on the other. Even if a party to a contract is owed no duty of disclosure, fraud or misrepresentation by the other party will almost invariably give him a legal basis for avoiding the contract. 12 Williston, *supra* note 2, at §§ 1487, 1488; Keeton, *supra* note 29, at 1-6 (note especially the distinction drawn between nondisclosure and "active concealment").

Each of these two general rules or principles makes sense from an economic point of view: a fiduciary relation can be viewed as a deliberate form of risk sharing (the beneficiary in effect purchases the other party's information), and fraud is economically undesirable because it positively increases the amount of misinformation in the market and is therefore likely to reduce the efficiency of the market as a mechanism for allocating resources. See generally Michael R. Darby & Edi Karni, Free Competition and the Optimal Amount of Fraud, 16 J. Law & Econ. 67 (1973).

I have chosen not to discuss these two problems because they are centered on difficult questions of fact (when does a fiduciary relation exist? where do we draw the line between nondisclosure and fraud?) about which it is difficult to generalize in a way that is theoretically interesting. The cases selected for discussion have been chosen, in part, because they do not raise questions of this sort.

The economic rationale for permitting nondisclosure is nicely illustrated by several cases involving the purchase of real estate where the buyer had reason to believe in the existence of a subsurface oil or mineral deposit unknown to the seller.[50] For example, in *Neill v. Shamburg*,[51] the parties were cotenants[52] of an oil lease on a 200-acre tract. The buyer (Shamburg) bought his cotenant's interest in the tract for $550 (with a provision for an additional $100 in case a well producing six or more barrels of oil a day should be found). At the time of the sale, Shamburg was operating several wells on an adjacent tract of land. One of the wells was quite valuable. Shamburg "directed his employees not to give information on this subject" and said nothing to his cotenant regarding the well when he purchased her interest in the 200-acre tract. The court held that Shamburg did not owe Neill any duty of disclosure and refused to set aside the sale of her half-interest in the oil lease. The court supported its conclusion with the following argument:

> The plaintiff [the seller] had no interest in the 50-acre lease, but we may concede that, when she was about to sell her part of the other lease to her co-tenant, she became entitled to know such facts with regards to its production as would bear upon the value of the other. [In light of what follows, the meaning of this sentence is not entirely clear.] But, unless there is some exceptional circumstance to put on him the duty to speak, it is the right of every man to keep his business to himself. Possibly,

[50] Fox v. Mackreth, 2 Bro. Ch. 400, 420, 30 Eng. Rep. 148 (1788) (dictum); Smith v. Beatty, 2 Ired. Eq. 456 (N.C. 1843); Harris v. Tyson, 24 Pa. 347 (1855); Stackpole v. Hancock, 40 Fla. 362, 24 So. 914 (1898); Holly Hill Lumber Co. v. McCoy, 201 S.C. 427, 23 S.E. 2d 372 (1942); William W. Story, *supra* note 27, at 442; 12 Williston, *supra* note 2, at § 1498.

[51] Neill v. Shamburg, 158 Pa. 263, 27 Atl. 992 (1893).

[52] The court held, *inter alia*, that their cotenancy did not create a fiduciary relation between the parties.

Shamburg was unduly suspicious on this point, but the nature and position of his business suggested caution. Fogle testifies that Shamburg was the only person operating in that neighborhood, *and James says that Shamburg told him he had spent near $150,000 in developing that territory, "and now all these fellows are anxious to pry into my business."* We do not find in the acts of Shamburg, under the circumstances, anything more than *a positive intention and effort to reap the benefit of his enterprise, by keeping the knowledge of its results to himself,* and we agree with the master that this "falls far short of establishing fraud."[53]

A more recent—and certainly a more dramatic—case of this sort arose in connection with Texas Gulf Sulphur's discovery of the fabulously rich Kidd Creek mine near Timmins, Ontario.[54] After conducting extensive aerial surveys which revealed a geological anomaly indicating the presence of massive sulphide deposits, Texas Gulf Sulphur purchased options covering mineral and surface rights from the owners of several adjacent lots on which the anomaly was located. One of these options covered a parcel of land owned by the estate of Murray Hendrie. The Hendrie option (which was obtained for $500) provided that Texas Gulf Sulphur could acquire mining rights to the property by the payment of $18,000 at any time during the two years immediately following execution of the option.[55] The option also provided that in case a commercial deposit of ore were discovered, the Hendrie estate would be given 10 percent of any profits. After the existence of the deposit became publicly known, representatives of the Hendrie estate protested that Texas Gulf Sulphur had intentionally misled the seller by failing to disclose that it had "an unusually promising indication of economic mineralization on the Hendrie property." A lawsuit, brought by the representatives, was eventually settled out of court.[56]

Both Shamburg and Texas Gulf Sulphur had reason to think that the land they were purchasing was far more valuable than the owner of the land believed it to be. In each case, the buyer's information regarding the value of

[53] Neill v. Shamburg, 27 Atl. 993 (1893). Italics added.

[54] For an account of the discovery, and subsequent events, see Morton Shulman, The Billion Dollar Windfall (1969).

[55] *Id.* at 82.

[56] As part of the settlement, Texas Gulf Sulphur agreed to purchase Hendrie's 10% share in the profits of the mine. The value of Hendrie's share has been estimated to be about $100,000,000. This fact, of course, considerably weakened his misrepresentation claim; in addition, the 10% provision should probably be regarded as a device for deliberately allocating the risk in question.

It is interesting to note that in a litigated case arising out of a related transaction, the Ontario High Court of Justice remarked that Texas Gulf Sulphur was only doing "What any prudent mining company would have done to acquire property in which it knew a very promising anomaly lay" when it purchased property "without causing the prospective vendors to suspect that a discovery had been made." Leitch Gold Mines, Ltd. v. Texas Gulf Sulphur, 1 Ontario Reports 469, 492-93 (1969).

the property was the product of a deliberate search, in which the buyer had invested a substantial sum of money. (In the four years before its discovery of the Kidd Creek deposit, Texas Gulf Sulphur spent nearly $3 million exploring other anomalies—with no results.)[57] The information, in both cases, revealed characteristics of the property which increased the efficiency of its utilization and, therefore, its value to society as a whole.

Information pertaining to the likelihood of a subsurface oil or mineral deposit will often be the fruit of a deliberate investment either in actual exploration or in the development of geological expertise. In order to encourage the production of such information, our legal system generally permits its possessor to take advantage of the ignorance of others by trading without disclosure.

A similar result is usually reached where the information concerns an anticipated development of some sort which will make the property more valuable.[58] In *Guaranty Safe Deposit & Trust Co. v. Liebold,*[59] for example, the trust company purchased an option on Liebold's property. It subsequently exercised the option and purchased the property for $15,000. Liebold sought to avoid the sale on the grounds "that at the time the option was secured, a company known as the Standard Steel Car Company contemplated coming to Butler [Pa.] to establish a large manufacturing plant; that Mr. Reiber [an agent of the trust co.] had knowledge of this matter, and while defendant had heard of the coming of some contemplated company, his knowledge was indistinct and indefinite, and the certainty of its coming was known to the plaintiff, who withheld his knowledge from defendant." The trial court found that both parties had known of the "rumor" that a manufacturing plant would be established in Butler, and that they had adjusted the price of the option accordingly. The Pennsylvania Supreme Court, in affirming a judgment for the trust company, had this to say:

[57] Morton Shulman, *supra* note 54, at 7. It is unlikely that Texas Gulf Sulphur could have benefited from its information in any other way than by purchasing the property on which the anomaly was located. If it had attempted to sell its information to the landowners, Texas Gulf Sulphur would have encountered two difficulties. It would first have had to convince the landowners of the value of the information without actually disclosing it. Second, it would have had to persuade all of the landowners involved to purchase the information jointly—since, in all likelihood, no single owner could pay a price that would compensate the corporation for the costs it had incurred in obtaining it. A multi-party transaction of this sort would involve obvious free-rider problems, and would be made especially difficult by the fact that disclosure of the information to one party would make it nearly impossible to conceal it from the others. If one owner obtains the information and begins mining, this will tip the others off and they will have no reason to buy the information themselves. Since it is reasonable to assume that the only effective way in which Texas Gulf Sulphur could profit from its information was by purchasing the rights to the property itself, a disclosure rule would have frustrated its only real hope of recovering the costs incurred in acquiring the information in the first place.

[58] See, for example, Burt v. Mason, 97 Mich. 127, 56 N.W. 365 (1893), and Furman v. Brown, 227 Mich. 629, 199 N.W. 703 (1924). See also 12 Williston, *supra* note 2, at § 1498 n.6.

[59] Guaranty Safe Deposit and Trust Co. v. Liebold, 207 Pa. 399, 56 A. 951 (1904).

Suppose Reiber had known definitely that the plant was to be established in Butler, and Liebold had been ignorant of this, was it the duty of the former to disclose such information to the latter, and can it be that, without such disclosure, his contract with Liebold is not enforceable in equity? In this commercial age, options are daily procured by those in possession of information from which they expect to profit, simply because those from whom the options are sought are ignorant of it. When the prospective seller knows as much as the prospective buyer, options can rarely, if ever, be procured, and the rule that counsel for appellant would have us apply would practically abolish them.[60]

Courts frequently have stated that in the absence of a confidential or fiduciary relation between buyer and seller, "a purchaser [of real estate], though having superior judgment of values, does not commit fraud merely by purchasing without disclosing his knowledge of value."[61] A rule of this sort makes economic sense where the buyer's judgment is based upon his prediction of the likelihood of various future uses to which the property might be put. Although a buyer's "knowledge of value" is not always based upon deliberately acquired information, the number of entrepreneurs involved in professional real estate speculation makes it plausible to assume that such knowledge is often (if not typically) acquired in a deliberate manner. (Real estate speculators, by matching buyers and sellers, facilitate the movement of real property to its most efficient use. The information on which their predictions of future use are based should therefore be regarded as a social asset.)

A third line of cases permitting nondisclosure appears, at first glance, to be inconsistent with the thesis argued here. These cases involve the sale of property which is *patently* defective in some way; courts regularly have found that the seller of such property has no duty to bring the defect to the buyer's attention.[62]

In *Gutelius v. Sisemore*,[63] for example, the plaintiff bought a house and subsequently discovered that rain water accumulated under the floors causing the residence "to become permeated with noxious and offensive odors." The buyer asserted that the tendency of water to accumulate was a latent defect, and that the defendant-seller had a duty to warn him of its existence. In finding for the defendant, the court said that an inspection of the premises (which the plaintiff had in fact made) should have acquainted the plaintiff with the conditions responsible for the accumulation of water. (The conditions cited included the placement of air vents, the slope of the ground surrounding the house, and the composition of soil in the yard.) "Where the means of knowledge are at hand and equally available to both parties," the

[60] *Id.* at 405, 56 A., at 953.

[61] Pratt Land & Improvement Co. v. McClain, 135 Ala. 452, 33 So. 185 (1902).

[62] See 37 Am. Jur. 2d § 157, and cases cited there.

[63] Gutelius v. Sisemore, 365 P.2d 732 (Okla. 1961).

court concluded, "and the subject of purchase is alike open to their inspection, if the purchaser does not avail himself of these means and opportunities, he will not be heard to say that he had been deceived by the vendor's misrepresentations."

If we assume that the seller in the *Gutelius* case knew or had reason to know that the buyer was unaware of the defect (despite the fact that the buyer had inspected the premises), he would be in much the same position as the recipient of a palpably mistaken bid, and if his knowledge of the buyer's error were not the fruit of a deliberate search, it would be reasonable to assume that the seller was the cheaper mistake-preventer—at least at the time of contracting. For reasons that will be considered in a moment, it is implausible to think that a seller's knowledge of defects in his own property is typically the result of a deliberate search in which he would not have invested had he known he would be required to disclose the existence of the defects in question. This being the case, on the assumption that the seller in *Gutelius* had reason to know of his buyer's error, it would seem to make sense, from an economic point of view, to require the seller to eliminate the error by bringing the defect to the buyer's attention. This is so despite the fact that both parties initially had an equal opportunity to discover the defect themselves—just as it is efficient to impose the risk of a mistaken bid on the party receiving it where he has reason to know of the mistake, despite the fact that the bidder was the party best able to prevent occurrence of the mistake in the first place.

But if a seller has no reason to know that his buyer is mistaken, it would be uneconomical to require him to notify the buyer of patent defects, since in all likelihood he would only be telling the buyer what the buyer already knows. Communications of this sort needlessly increase transaction costs. The critical issue in a case like *Gutelius*, therefore, is not whether knowledge of the defect was "equally available to the parties" at some previous moment in time, but whether the seller, at the time the contract is executed, actually knows or has reason to know that the buyer is mistaken. The rule that a seller of real property has no duty to disclose patent defects makes economic sense where—as is often the case—the seller has no reason to know that the buyer is mistaken. These cases (of which *Gutelius* is an example) appear to conflict with the interpretation offered here only because of their failure to explicitly discuss this key issue, focusing instead on the parties' initial parity of access to information concerning the defect.

With regard to *latent* defects, the older authorities are equivocal. Some cases state that a seller who is aware of such a defect must disclose it to his buyer or forgo the bargain.[64] Others state that the seller is privileged to

[64] See generally, William W. Story, *supra* note 27, at 444–45; James Kent, 2 Commentaries § 482 n.1 (12th ed. 1873).

remain silent if he wishes.[65] In the last twenty-five years, however, there has been a marked expansion of the duty to disclose latent defects.[66] One particularly dramatic illustration involves the sale of a home infested with termites. A seller of a house in Massachusetts in 1942 was held to have no legal duty to disclose the existence of a termite infestation of which the buyer was ignorant.[67] If it were to impose such a duty, the Massachusetts Supreme Court declared, it would make every seller liable "who fails to disclose any nonapparent defect known to him in the subject of the sale which materially reduces its value and which the buyer fails to discover." Similarly, the court went on to say, "it would seem that every buyer would be liable who fails to disclose any nonapparent virtue known to him in the subject of the purchase which materially enhances its value and of which the seller is ignorant."

Eighteen years later, in *Obde v. Schlemeyer*,[68] a Washington seller was held to have a duty to disclose under identical circumstances. The Washington court concluded that the seller had a duty to speak up, "regardless of the [buyer's] failure to ask any questions relative to the possibility of termites," since the condition was "clearly latent—not readily observable upon reasonable inspection." The court bolstered its argument with a long quotation from an article by Professor Keeton:

> It is of course apparent that the content of the maxim "caveat emptor", used in its broader meaning of imposing risks on both parties to a transaction, has been greatly limited since its origin. When Lord Cairns stated in Peek v. Gurney that there was no duty to disclose facts, however morally censurable their non-disclosure may be, he was stating the law as shaped by an individualistic philosophy based upon freedom of contract. It was not concerned with morals. In the present state of the law, the decisions show a drawing away from this idea, and there can be seen an attempt by many courts to reach a just result in so far as possible, but yet maintaining the degree of certainty which the law must have. The statement may often be found that if either party to a contract of sale conceals or suppresses a material fact which he is in good faith bound to disclose then his silence is fraudulent.
>
> The attitude of the courts toward non-disclosure is undergoing a change and contrary to Lord Cairns' famous remark it would seem that the object of the law in these cases should be to impose on parties to the transaction a duty to speak whenever justice, equity, and fair dealing demand it.[69]

However one feels about Professor Keeton's moral claim, requiring the disclosure of latent defects makes good sense from the more limited perspective offered here. In the first place, it is likely to be expensive for the buyer to discover such defects; the discovery of a latent defect will almost always require something more than an ordinary search. Even where neither party has knowledge of the defect, it may be efficient to allocate to the seller the risk of a mistaken belief that no defect exists, on the grounds that of the two parties he is likely to be the cheapest mistake-preventer.[70]

Where the seller actually knows of the defect, and the buyer does not, the seller is clearly the party best able to avoid the buyer's mistake at least cost—unless the seller has made a deliberate investment in acquiring his knowledge which he would not have made had he known he would be required to disclose to purchasers of the property any defects he discovered. A seller, of course, may make a substantial investment in acquiring information concerning a particular defect: for example, he may hire exterminators to check his property for termites. But even so, it is unlikely that his principal aim in acquiring such information is to obtain an advantage over potential purchasers. Typically, homeowners conduct investigations of this sort in order to protect their own investments. In most cases, a homeowner will have an adequate incentive to check for termites even if the law requires him to disclose what he discovers;[71] furthermore, many termite infestations are discovered by simply living in the house—something the owner will do in any event. A disclosure requirement is unlikely to have a substantial effect on the level of investment by homeowners in the detection of termites: the point is not that information regarding termites is costless (it isn't), but that a disclosure requirement would not be likely to reduce the production of such information. This represents an important distinction between cases like *Obde*, on the one hand, and those like *Laidlaw*, *Shamburg*, and *Guaranty Safe*, on the other.

A seller of goods might argue that a rule requiring him to disclose latent defects will discourage him from developing (socially useful) expertise regarding the qualities or attributes of the goods he is selling: if he cannot enjoy its fruits by selling without disclosure, what incentive will he have to acquire

[65] Swinton v. Whitinsville Sav. Bank, 311 Mass. 677, 42 N.E.2d 808 (1942). See also Perin v. Mardine Realty Co., 5 App. Div. 2d 685, 168 N.Y.S. 2d 647 (1957).

[66] William B. Goldfarb, Fraud and Nondisclosure in the Vendor-Purchaser Relation, 8 W. Res. L. Rev. 5 (1956); Leo Bearman, Jr., Caveat Emptor in Sales of Realty—Recent Assaults Upon the Rule, 14 Vand. L. Rev. 541 (1961). Two illustrative cases are Kaze v. Compton, 283 S.W.2d 204 (Ky. 1955), and Cohen v. Vivian, 141 Colo. 443, 349 P.2d 366 (1960).

[67] Swinton v. Whitinsville Sav. Bank, 311 Mass. 677, 42 N.E.2d 808 (1942). See also Perin v. Mardine Realty Co., 5 App. Div. 2d 685, 168 N.Y.S.2d 647 (1957).

[68] Obde v. Schlemeyer, 56 Wash. 2d 449, 353 P.2d 672 (1960). See also Williams v. Benson, 3 Mich. App. 9, 141 N.W.2d 650 (1966); Cohen v. Blessing, 259 S.C. 400, 192 S.E.2d 204 (1972), Annot., 22 A.L.R.3d 972.

[69] Keeton, *supra* note 29, at 31.

[70] Because of his superior access to the relevant information. See Posner, *supra* note 2, at 74-75.

[71] This will not be true in every case. It may not be true, for example, if the homeowner plans to sell his home in the immediate future.

such expertise in the first place? This argument is rather unconvincing. A seller benefits in many different ways from his knowledge of the various attributes which his goods possess. For example, expertise of this sort enables him to be more efficient in purchasing materials, and reduces the likelihood that he will fail to identify any special advantage his goods enjoy (and therefore undersell them). Because the benefits which he derives from such knowledge are many and varied, it is unlikely that a duty to disclose latent defects will by itself seriously impair a seller's incentive to invest in acquiring knowledge regarding the attributes of what he sells.

By contrast, the usefulness of market information (as distinct from information regarding the attributes of goods held for sale) is substantially reduced by imposing a duty to disclose on its possessor. It is doubtful whether the benefits of market information which are not eliminated by a disclosure requirement are sufficient by themselves to justify a deliberate investment in its production. Consequently, even if we regard these two kinds of information—market information and product information—as equally useful from a social point of view, a legal rule requiring disclosure is likely to have a different impact upon the production of each. It follows from what I have just said that a rule permitting nondisclosure of market information is sensible whether the party possessing the information is a buyer or a seller.[72] Thus, if the seller in *Laidlaw* had known the treaty would have a depressing effect on the price of cotton and had sold to the buyer without disclosing this fact, the economic considerations favoring enforcement would be the same as where the buyer had acquired special information. Although economic considerations would appear to support similar treatment for buyers and sellers possessing market information, these same considerations may justify different treatment where product information is involved. It should be clear, from what I have already said, that there is no inconsistency in requiring sellers to disclose latent defects, while not requiring buyers to disclose latent advantages.

The latent defect cases have an interesting analogue in the insurance field. An applicant for a life insurance policy is usually held to have a duty to disclose known "defects" in his own constitution.[73] For example, if an applicant has a history of heart trouble which the insurance company's own medical examination fails to reveal, and he does not disclose the problem himself, the insurance company will usually be permitted to set the contract of insurance aside.[74] In many cases, of course, an applicant's failure to disclose will constitute actual fraud (this will be so, for example, if a question on the application asks him whether he has a history of heart trouble and he answers that he does not).[75] But even in the absence of fraud, an applicant is usually held to have a positive duty to speak up even where he has not been asked a specific question.[76] In this respect, the same disclosure is required of one who purchases an insurance policy as is required of a seller who sells a house with a latent defect (such as a termite infestation). From an economic point of view, these two cases are quite similar and it is therefore understandable that the same disclosure requirement should be applied to each. Because of his intimate familiarity with his own medical history and symptoms, an applicant for an insurance policy will typically be in a better position than the insurance company itself to prevent a mistake by the company regarding some latent defect in the applicant's constitution. More importantly, an applicant will have a strong incentive to acquire information concerning his own health whether or not we impose a disclosure requirement on him.[77] In this sense, he resembles the homeowner who will have an incentive to protect his home from destruction by termites whether we require him to disclose the existence of a termite infestation or not. Both the homeowner and the insurance applicant have an independent reason for producing information of this sort, and the value to them of the information will in most cases be unimpaired by a disclosure requirement.

[72] This point has long been recognized. See William W. Story, *supra* note 27, at 444-45. See also the classic discussion of the problem in Book 3 of Marcus Tullius Cicero's, De Officiis (Loeb Classical Library 1975).

[73] For a thorough discussion of the duty to disclose in the context of insurance contracts, see Edwin W. Patterson, Essentials of Insurance Law 444-73 (1957). At one point in his discussion, Professor Patterson makes an "economic" point similar to the one developed in this paper:

> "The doctrine of concealment in relation to insurance contracts is, and long has been, an exceptional rule. In commercial contracts, and in all others between persons dealing at arm's length, A, one party, is not required to *volunteer*, at the time of negotiating the contract, disclosure to the other, B, of A's knowledge of fact X, which he knows that B does not know and which A knows B would deem material to the making of the contract. For example, if A offers to sell B a large quantity of coffee beans, knowing, as B does not, that the report of a prospective coffee-crop failure in Brazil was false, B, contracting to buy in ignorance of this fact, cannot avoid the contract on the ground of A's silence. [Citing *Laidlaw v. Organ*.] The policy supporting this rule is based on the economic function of 'the market,' as a process whereby the best-informed traders provide a medium for the selling and buying of property at the 'best' prices obtainable, and for this public service they are rewarded by being allowed to profit by their special knowledge. The bargaining process on a 'free market' would become tedious and unstable if each bargainer had to tell the other all his reasons for the price he asks or bids."

Id. at 446-47.

[74] See Equitable Life Assurance Soc'y of United States v. McElroy, 83 Fed. 631 (8th Cir. 1897) (nondisclosure of an operation for appendicitis in the interim period between signing the application for insurance and completion of the contract); Stipcich v. Metropolitan Life Ins. Co., 277 U.S. 311 (9th Cir. 1928) (dictum).

[75] Edwin W. Patterson, Essentials of Insurance Law 458 (1957).

[76] Assuming that he has reason to believe the nondisclosed fact is materially relevant to the risk the insurer is assuming. *Id.* at 456.

[77] This will not be true in every case. If he knows that he must disclose whatever he discovers, an applicant with disturbing symptoms may forgo a medical examination for fear of what it will reveal (just as a disclosure requirement may in some circumstances discourage a homeowner contemplating sale from inspecting for termites).

C. *The Duty to Disclose and the Restatements*

In addition to generating a substantial case law, the problem of disclosure in bargain transactions has also been addressed by the draftsmen of three different Restatements. It is instructive to compare the treatment which the problem of disclosure has received at the hands of the restaters. The analysis developed in this paper suggests that the different restaters were closer in their thinking about disclosure than might appear to be the case.

Section 472(1)(b) of the Restatement of Contracts (First) provides that "there is no duty of disclosure, by a party who knows that the other party is acting under a mistake as to undisclosed material facts, and the mistake if mutual would render voidable a transaction caused by relying thereon. . ." Like many of the Restatement's black-letter principles, this one is rather shapeless, and acquires content only by the examples which are offered to illustrate its meaning. Two of the five illustrations appended to Section 472 involve situations which appear to be within the contemplated scope of Section 472(1)(b). The two examples are these.

A owns two tracts of land, Blackacre and Whiteacre. B makes a written offer to buy Blackacre for $10,000. A knows that B is under a mistake as to the names of the tracts and that the more valuable tract, Whiteacre, is the one that B has in mind. A accepts B's offer without disclosing B's mistake to him. Though A is in no way the cause of B's original mistake, the lack of disclosure is fraud.

A learns that the business of C, a corporation, has suffered a serious loss. He knows that B is ignorant of the loss, and without disclosing it to B, contracts to sell to B shares in the corporation. A has no fiduciary relation to B. A's non-disclosure is not fraud. If the mistake had been mutual it would not have made the contract voidable.[78]

In each case, one party is mistaken and the other party knows it. In both cases the party with knowledge is the seller. What distinguishes the two cases is the *kind* of knowledge they involve. Only the knowledge involved in the second case (a species of market information) is likely to be the fruit of a search in which the knowledgeable party has made a deliberate investment. The seller's special knowledge in the first case comes to him—in the most literal sense—by accident. Requiring him to disclose the other party's error will not give the seller in the first case a disincentive to do anything he would not have done anyway; imposing a similar requirement on the seller in the second case may very well have a disincentive effect of this sort. Although today the result in the second case would undoubtedly be affected by our complex securities laws, it does suggest that in framing an appropriate disclosure rule, the draftsmen of the First Restatement of Contracts intuitively

[78] Restatement of Contracts § 472, Illustrations 2 & 4 (1932).

attached great importance to the distinction drawn here between two different kinds of knowledge or information.

The treatment of disclosure in the Second Restatement of Torts also accords with the analysis offered here. Section 551(2)(e) states that "one party to a business transaction is under a duty to disclose to the other before the transaction is consummated facts basic to the transaction, if he knows that the other is about to enter into the transaction under a mistake as to such facts, and that the other, because of the relationship between them, the customs in the trade, or other objective circumstances, would reasonably expect a disclosure of such facts."[79] In an explanatory comment accompanying Section 551, the draftsmen note that

to a considerable extent, fully sanctioned by the customs and mores of the community, superior information and better business acumen are legitimate advantages, which lead to no liability. The defendant may reasonably expect the plaintiff to make his own investigation, draw his own conclusions, and to protect himself; and if the plaintiff is indolent, inexperienced or ignorant, or his judgment is bad, or he does not have access to adequate information, the defendant is under no obligation to make good his deficiencies. This is true in general, where it is the buyer of land or chattels who has the better information and fails to disclose it; somewhat less frequently, it may be true of the seller.[80]

Section 551(2)(e) is illustrated with the following example.

A is a violin expert. He pays a casual visit to B's shop where second-hand musical instruments are sold. He finds a violin which, by reason of his expert knowledge and experience, he immediately recognizes as a genuine Stradivarius, in good condition, and worth at least $50,000. The violin is priced for sale at $100. Without disclosing his information or his identity, A buys the violin from B for $100. A is not liable to B.[81]

Although *A*'s visit to *B*'s shop is described as "casual," *A* has certainly incurred costs in building up his knowledge of musical instruments and one of his anticipated benefits may have been the discovery of an undervalued masterpiece. (Whether this is true will depend, in part, upon what it means to be a "violin expert." Is a "violin expert" someone who plays the instrument, or who collects them? If the latter, then the discovery of an unrecognized Stradivarius is more likely to be one of the important benefits which the expert anticipates from his special knowledge.) Regardless of *A*'s particular motives for becoming an expert, it is plausible to think that many discoveries of the sort described in the example are the result of a deliberate search in the sense defined above.

[79] Restatement (Second) of Torts § 551(2)(e) (Tent. Draft No. 11, 1965).

[80] *Id.* Comment *e*, at 50.

[81] *Id.*

Locating valuable instruments which have been incorrectly identified by their owners serves a useful social purpose: after the Stradivarius has been discovered, it will undoubtedly find its way into the hands of a higher-valuing user (for example, a concert violinist or a university with a collection of rare instruments). An undiscovered Stradivarius is almost certainly misallocated. By bringing it to light, a bargain-hunting expert in musical instruments promotes the efficiency with which society's scarce resources are allocated. If he has incurred costs in doing so (and the development of expertise is one—perhaps the most important—of these costs), the bargain hunter will be discouraged from future searching if he is not given a property right in whatever information he acquires (in the form of a privilege to deal without disclosing).

By the same token, since it enables him to benefit (costlessly) from the other party's special information and eliminates the risk that he will be unable to recover an undervalued masterpiece which he sells by mistake, a disclosure requirement also reduces the owner's incentive to search (that is, to correctly identify the attributes of his own property). Because it reduces the incentive of both the owner and the bargain-hunter to undertake a deliberate search, a disclosure requirement increases the likelihood that the instrument will remain undiscovered and therefore misallocated.

The draftsmen of the Second Restatement of Torts offer four examples to illustrate the circumstances in which Section 551(2)(e) would require a party with special information to disclose what he knows. In the first case, a seller sells a house "without disclosing the fact that the drain tile under the house is so constructed that at periodic intervals it accumulates water under the house"; in the second case, the owner of a business sells it to someone without disclosing that he has been ordered by the United States Government to discontinue his principal activity; in the third case, the owner of an amusement center sells it "without disclosing the fact that it has just been raided by the police, and that [the seller] is being prosecuted for maintaining prostitution and the sale of marijuana on the premises"; and in the last case, one party sells a summer resort to another without disclosing that a substantial portion of the resort encroaches on a public highway. The special knowledge involved in each of these four examples is unlikely to be the intended product of a deliberate search for information in which the knowing party has made an investment he would not otherwise have made. They may all be distinguished, in this regard, from the violin hypothetical. The line which the draftsmen of the Second Restatement of Torts draw between the duty to disclose and the privilege to remain silent is drawn where the analysis developed in this paper would suggest it should be.

The Restatement of Restitution treats the problem of disclosure in Section 12: "A person who confers a benefit upon another, manifesting that he does so as an offer of a bargain which the other accepts or as the acceptance of an offer which the other has made, is not entitled to restitution because of a mistake which the other does not share and the existence of which the other does not know or suspect." In Comment *c* to Section 12 the draftsmen state: "Where the transferee knows or suspects the mistake of the transferor, restitution is granted if, and only if, the fact as to which the mistake is made is one which is at the basis of the transaction unless there is a special relation between the parties." Comment *c* is illustrated by two examples.

A, looking at cheap jewelry in a store which sells both very cheap and expensive jewelry, discovers what he at once recognizes as being a valuable jewel worth not less than $100 which he correctly believes to have been placed there by mistake. He asks the clerk for the jewel and gives 10¢ for it. The clerk puts the 10¢ in the cash drawer and hands the jewel to A. The shopkeeper is entitled to restitution because the shopkeeper did not, as A knew, intend to bargain except with reference to cheap jewelry.

A enters a second-hand bookstore where, among books offered for sale at one dollar each, he discovers a rare book having, as A knows, a market value of not less than $50. He hands this to the proprietor with one dollar. The proprietor, reading the name of the book and the price tag, keeps the dollar and hands the book to A. The bookdealer is not entitled to restitution since there was no mistake as to the identity of the book and both parties intended to bargain with reference to the ability of each to value the book.[82]

The second example closely resembles the violin hypothetical in the Second Restatement of Torts and makes economic sense for the same reasons. The first example is more puzzling. The one important factual difference between the first example and the second one is that while the latter involves a secondhand store, the former involves a store which sells new, high quality merchandise as well as inferior goods. Why should this make a difference so far as the knowledgeable party's duty to disclose is concerned? The restaters distinguish the two situations in terms of the parties' intentions to bargain. This explanation is unsatisfactory, however, since it fails to indicate why their intentions should be different in the two cases. An alternative way of reconciling the two apparently contradictory examples might be the following.

One can easily imagine an expert (in violins or books) browsing in secondhand stores in the hope of finding an undervalued masterpiece. It seems less likely, however, that a bargain hunter would spend time searching the display cases of a fine jewelry store that also sells inferior goods in the hope of finding a gem which has been misclassified.

The owner of a fine jewelry store is almost certain to be an expert in discriminating between valuable jewels and paste. Since he is an expert, and typically takes great care in sorting his own goods, it is unlikely that he will

[82] Restatement of Restitution § 12, Comment c, Illustrations 8 & 9 (1936).

make an error of classification. If similar errors occur more frequently in secondhand bookstores (either because their owners, generally speaking, lack expertise or are careless in sorting), a bargain-hunting expert will be more likely to discover an undervalued item there than he would in a jewelry store which sells both fine gems and junk. Assuming this to be true, one would expect to find more deliberate searches in the one case than in the other. It would follow that a disclosure requirement is more appropriate in the jewelry store setting than in the sale of secondhand books.

This explanation is admittedly a rather tenuous one which rests upon an undemonstrable assumption regarding the incidence of errors of classification in the two cases. If the explanation is unsatisfactory, however, this may itself be a reason for rejecting the view of the restaters or for believing that it does not accurately restate the law.

III. Unilateral Mistake and the Duty to Disclose

The rule that a unilaterally mistaken promisor will be excused when his mistake is known or should be known to the other party is typified by the mistaken bid cases and by those in which the mistaken party's error is the result of his having misread a particular document (usually, the proposed contract itself). In both instances, the special knowledge of the non-mistaken party (his knowledge of the other party's error) is unlikely to be the fruit of a deliberate search. Put differently, a rule requiring him to disclose what he knows will not cause him to alter his behavior in such a way that the production of information of this sort will be reduced.

A contractor receiving a mistaken bid, for example, usually becomes aware of the mistake (if he does at all) by comparing the mistaken bid with others that have been submitted, or by noting an error which is evident on the face of the bid itself. In either case, his knowledge of the mistake arises in the course of a routine examination of the bids which he would undertake in any event. The party receiving the bid has an independent incentive to scrutinize carefully each of the bids which are submitted to him: the profitability of his own enterprise requires that he do so. It is of course true that the recipient's expertise may make it easier for him to identify certain sorts of errors in bids that have been submitted. But the detection of clerical mistakes and errors in calculation is not likely to be one of the principal reasons for his becoming an expert in the first place. A rule requiring the disclosure of mistakes of this kind is almost certain not to discourage investment in developing the sort of general expertise which facilitates the detection of such mistakes.

In the first part of the paper, I argued that a rule requiring disclosure where a unilateral mistake is known or reasonably knowable by the other party makes economic sense because the party with knowledge is—at the time the contract is executed—the cheaper mistake-preventer. If the party possessing special information has deliberately invested in its production—and if the information is socially useful (so that we regard its production as desirable in the first place)—the costs of his search must be considered in determining whether he is in fact the cheaper mistake-preventer. In the cases which are most often cited to support the proposition that a unilateral mistake will excuse where it is known or reasonably knowable by the other party (*i.e.*, the mistaken bid and misread document cases), it is unlikely that the special information in question is the fruit of a deliberate investment. This being so, the conclusion reached in the first part of the paper is confirmed.

The unilateral mistake cases are indistinguishable, in principle, from the other contract cases, discussed in the second part of the paper, which impose a duty to disclose. These cases are distinguished as a group by the fact that in each of them the social interest in efficiency is best served by allocating the risk of a unilateral mistake to the party with knowledge (since this is unlikely to discourage him from investing in the production of socially useful information). In the cases permitting nondisclosure, a similar allocation of risk would—as I have attempted to show—eliminate the private incentive for producing such information and would therefore work to the disadvantage of society as a whole. When viewed in this way, both the cases requiring disclosure (including the unilateral mistake cases) and those permitting nondisclosure appear to conform to (or at least to be consistent with) the principle of efficiency.

Conclusion

In this paper, I have emphasized the way in which one branch of the law of contracts promotes efficiency by encouraging the deliberate search for socially useful information. It does so, I have argued, by giving the possessor of such information the right to deal with others without disclosing what he knows. This right is in essence a property right, and I have tried to show that the law tends to recognize a right of this sort where the information is the result of a deliberate and costly search and not to recognize it where the information has been casually acquired. This basic distinction between two kinds of information (and the theory of property rights which is based upon it) introduces order into the disclosure cases and eliminates the apparent conflict between those cases which permit nondisclosure and the well-established rule that a unilaterally mistaken promisor will be excused if his error is or reasonably should be known by the other party.

Although I have confined my discussion to contract law—indeed, to one rather small part of it—the theoretical approach developed in the second part of the paper may prove to be useful in analyzing related problems in other areas of the law. For example, to what extent can the disclosure requirements in our securities laws which are aimed at frustrating insider-trading be said to rest upon (and to be justified by) the idea that inside information is more likely to be casually discovered rather than deliberately produced?[83] If this is in fact one of the principal assumptions underlying the various disclosure requirements imposed by our securities laws, what conclusions—if any—can be drawn regarding the proper scope of these requirements? For example, how much should a tender offeror have to publicly disclose concerning his plans for the corporation he hopes to acquire? Does the analysis offered in this paper throw any light on the requirement of "non-obviousness" in patent law?[84] (Is this perhaps a legal device for discriminating between information which is the result of a deliberate search and information which is not?) Do the distinctions suggested here help us to understand the proliferation of disclosure requirements in the consumer products field and to form a more considered judgment as to their desirability? A legal theory which provided a common framework for the analysis of these and other questions would have considerable appeal.

[83] Useful discussions of the economics of disclosure requirements in the securities field may be found in Henry G. Manne, Insider Trading and the Stock Market (1966), and Eugene F. Fama & Arthur B. Laffer, Information and Capital Markets, 44 J. Bus. 289, 297-98 (1971).

[84] See Edmund W. Kitch, Graham v. John Deere Co: New Standards for Patents, 1966 Sup. Ct. Rev. 293.

ECONOMICS OF ALIMONY

*ELISABETH M. LANDES**

THE first half of this decade has been a period active in divorce reform. Rapidly rising divorce rates, coupled with increased public tolerance of private behavior, have brought into question the state's role in regulating divorce. At this writing, at least thirty states permit divorce on grounds of "marital breakdown" or incompatibility.[1]

The aspect of divorce law of particular interest in this paper is the provision of alimony. The great majority of states provide for alimony payments in the event of separation or divorce,[2] and although most jurisdictions authorize alimony to either spouse under appropriate circumstances, alimony is almost exclusively awarded to wives. In addition, the amount of the award tends to vary with the length of marriage, the number of children, and the husband's and wife's relative assets and earning power.

In the first part of this paper, I develop a simple model of household production to illuminate the relevance of the length of marriage, number of children, and the wife's earning ability to an efficient determination of alimony. I show that if all marital income were perfectly divisible (*i.e.*, no public goods) and if spouses could negotiate with each other and transfer income between themselves costlessly, a legal rule requiring mutual consent for divorce would be equivalent (in most respects) to one permitting unilateral divorce by either spouse.

In the absence of these conditions, alimony serves as an efficient means of redistributing the property rights and assets of the marriage partnership between the spouses, enabling them to reach an "optimal" end—the dissolution of their marriage. I argue that the role of alimony is to compensate the wife for the opportunity costs she incurs by entering and investing in the marriage. As such, the award and enforcement of alimony payments by the

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[1] California was the first state (1969) to make breakdown the exclusive ground for divorce.

[2] Only Texas, Delaware, and Pennsylvania do not permit the courts to award alimony in the event of divorce. The theory is that alimony is part of the duty to support and hence is contingent on the existence of the marriage. See Henry H. Foster & Doris Jonas Freed, Divorce Reform: Brakes on Breakdown, 13 J. Fam. L. 443 (1973-74).

APPENDIX C

This is a listing of all 2004 Washington Super Lawyers, arranged by primary area of practice. This listing should not be construed to mean a lawyer is a certified specialist in the indicated practice area. Page numbers in **BOLDFACE** indicate a profile on the specified page.

hn, U.S. Attorney's Office, Seattle 206-553-7970
ırda D., WA State Attorney General, Olympia -6200 Pg. 53

HEALTH CARE LAW

lley James, Foster Pepper & Shefelman, Seattle -4400
ıald W., Ogden Murphy Wallace, Seattle -7000 **Pg. 84**
ren Elaine, Preston Gates & Ellis, Seattle -7624
Robert Gale, Davis Wright Tremaine, Seattle ·7676
ıes Christopher, Attorney at Law, Mercer Island 1131
ɔri, Foster Pepper & Shefelman, Seattle 7895
avid B., Bennett Bigelow & Leedom, Seattle 5511
arbara Allan, Riddell Williams, Seattle 1680
am G., Inslee Best Doezie & Ryder, Bellevue 1234 **Pg. 125**
andall Lee, Stamper Rubens Stocker & Smith , 509-326-4800 **Pg. 126**
: D., Group Health Cooperative, Seattle 5161

IMMIGRATION

Janet Holste, Ryan Swanson & Cleveland, Seattle !235 **Pg. 89**
Cowan, Pamela Sue, Cowan & Miller, Seattle 206-340-1033 Pg. 53, **92**
Fuentes, Lourdes, MacDonald Hoague & Bayless, Seattle 206-622-1604 **Pg. 99**
Lederman, Kevin, MacDonald Hoague & Bayless, Seattle 206-622-1604 **Pg. 110**
Miller, Steven Soloman, Cowan & Miller, Seattle 206-340-1033
Paget, Joel H., Ryan Swanson & Cleveland, Seattle 206-464-4224 **Pg. 117**
Smith, Daniel Hoyt, MacDonald Hoague & Bayless, Seattle 206-622-1604
Wood, Jacqueline A., Attorney at Law, Bainbridge Island 206-842-3625

IN-HOUSE COUNSEL

Adams, Matthew Stuart, Unigard Insurance Company, Bellevue 425-945-5305
Billingslea, Everett H., Lynden Incorporated, Seattle 206-439-5490
Boggs, Paula Elaine, Starbucks Coffee Company, Seattle 206-318-1575
Boyce, Kimberly Ann, Attorney at Law, Seattle 206-781-3480
Chase, Roger F., PHC Office of Legal Affairs, Spokane 509-474-4900
Dauber, Paul Bruce, Onyx Software, Bellevue 425-519-4115
Fielden, Timothy G., Microsoft Corporation, Redmond 425-705-9683
Gadre (Rudy), Aniruddha, Amazon.com, Seattle 206-266-6556
Helm, Lucy Lee, Starbucks Coffee Company, Seattle 206-318-8543
Jefferson, Sherri Lynn, Starbucks Coffee Company, Seattle 206-318-8242
Lapham, John J., Getty Images, Seattle 206-925-6429
Piraino, Michael C., WatchGuard Technologies, Seattle 206-613-3751
Tanzi, Lisa Jean, Microsoft Corporation, Redmond 425-706-8947
Weinstein, Christopher Gordon, Microsoft Corporation, Redmond 425-882-8080
Wilson, L. Michelle, Amazon.com, Seattle 206-266-1000 Pg. 53
Wright, Jonathan K., Targeted Genetics Corporation, Seattle 206-623-7612
Yates, Sarah Barian, Group Health Cooperative, Seattle 206-448-6161
Zapolsky, David A., Amazon.com, Seattle 206-266-1323

INSURANCE COVERAGE

Ahearne, Thomas Fitzgerald, Foster Pepper & Shefelman, Seattle 206-447-8934
Brenner, David M., Riddell Williams, Seattle 206-624-3600
Dinning, Ronald Stanford, Merrick Hofstedt & Lindsey, Seattle 206-682-0610
Dykstra, A. Richard, Stafford Frey Cooper, Seattle 206-623-9900 **Pg. 95**
Edmonds, Jerry Bruce, Williams Kastner & Gibbs, Seattle 206-628-6639 **Pg. 96**
Jones, Thomas M., Cozen O'Connor, Seattle 206-224-1242 **Pg. 106**
Kilpatrick, Richard B., Attorney at Law, Bellevue 425-453-8161
Paulich, Patrick M., Thorsrud Cane & Paulich, Seattle 206-386-7755 **Pg. 118**

cont'd on page 72

·m, Oregon, native joined the Associated ·s as a reporter in Seattle. Davis knew y on she wanted to shift to broadcast s. But she got a sense of how things were n the news director at a major Seattle ·tation rebuffed her, saying, "We already one woman on the air."

'hat only steeled her resolve. After a year AP, she landed a position for KUUU- a Seattle oldies station. Davis was ·ing anchor; and in the afternoons d around town in the station's red Mustang to report live on breaking . In 1971, she moved with her hus- , Don, to Spokane so he could attend ·chool at Gonzaga University. Here, ·ade the transition to TV news, as a ter for CBS affiliate KXLY-TV, and the local NBC affiliate, KHQ-TV. then, reporters also operated cam- nd edited their own film.

·t once she advanced to where she ·t she wanted to be, the bloom came off ·se. Davis says her shift to law was ted by two things. First, watching her ·d go through law school at Gonzaga d her, she says. Second, she adds, "I felt that broadcast journalism wasn't doing its job. There was a tendency to cover fluff, to not dig into the tougher, meatier stories." The last straw came when her copy was reviewed by the news director because of worries from a major advertiser caught in the middle of a controversial story.

Davis graduated from UW law school and passed the bar in 1977. She hasn't looked back. She joined Burns and Schneiderman, then a small Seattle personal-injury and criminal law firm. She says the two principals, Jim Burns and Barry Schneiderman, "were wonderful teachers. They always had their doors open, and I never felt that any question I asked was [considered] a dumb one."

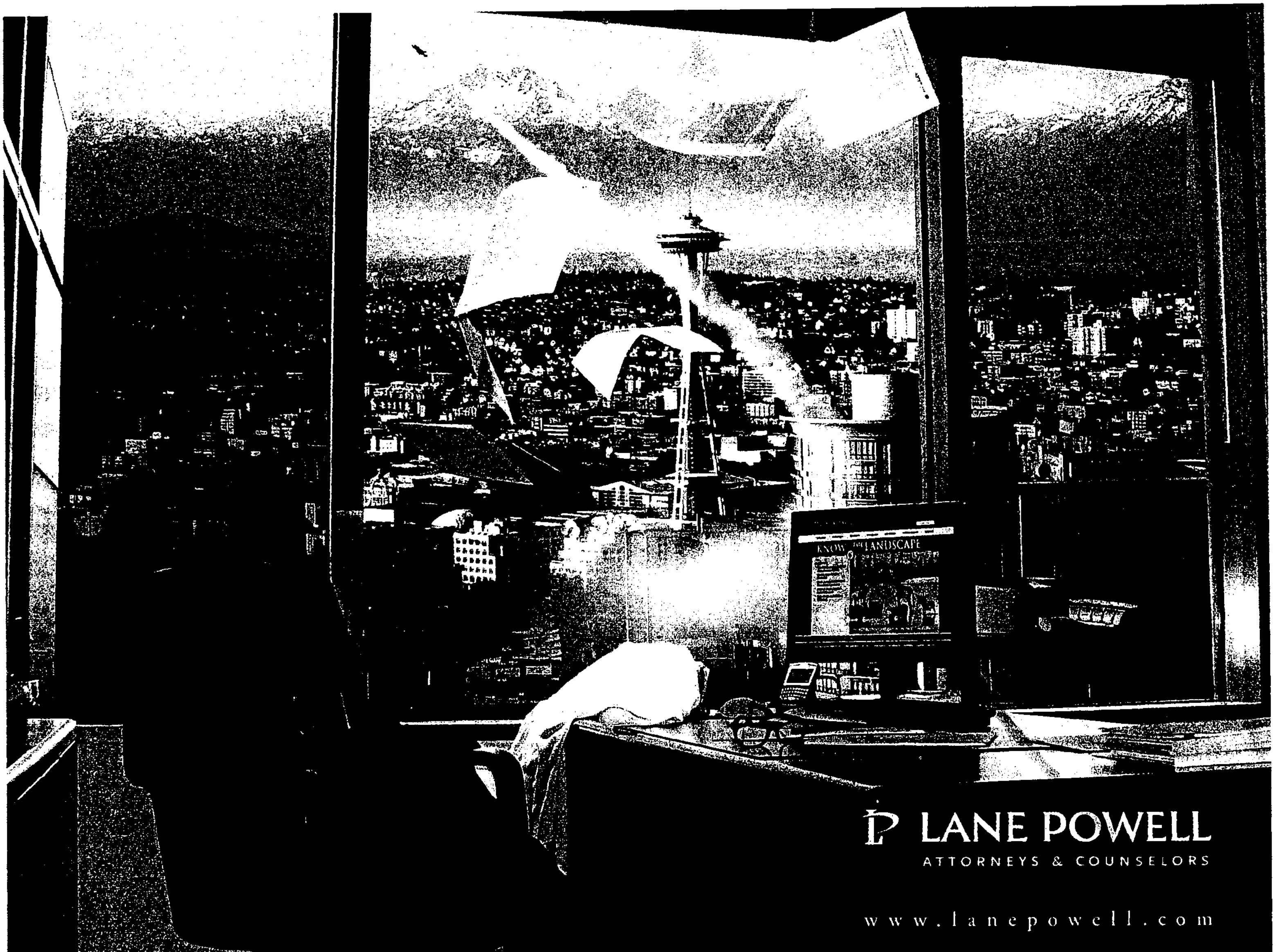
One big case for Davis was a settlement the firm won on behalf of Paccar assembly workers, against a polyurethane foam manufacturer. The foam contained a potentially hazardous chemical called isocyanate, which workers hosed into the walls of refrigerator railroad cars without having been informed that fans, exhaust systems and other precautions were required, Davis says. A number of employees developed emphysema or asthma.

In 1986, Davis became the first woman president of the Washington Trial Lawyers Association. The next year, she and her husband opened The Davis Firm, in Seattle's Ballard neighborhood. They're still going strong, handling a range of personal injury cases. Davis says her work often requires her to learn about "stuff I knew nothing about," from the engineering of hydraulic jacks, to severe burns, to maritime and aviation safety.

Davis, 55, says she definitely sees some overlap with her past life as a news reporter.

"I love to dig through the information, and put together the story of what happened. In many ways it's similar to doing TV news. It may include witnesses, documents, photos, audio, animated presentations, or a model. Being able to put it together in a coherent manner is really important."

Chatting at Uptown Espresso in Lower Queen Anne, Davis exudes a calm satisfaction with her choices. "I'm glad I made the change. If I don't believe in the person or the cause, I say, 'No, thanks.' With any luck, I'm just working for what I believe in."



ust be one of those Lane Powell *Super Lawyers*

ıgratulations

ı J. Amster
state & Land Use

G. Beard
:ts Liability & Martime

on P. Beck
uction Litigation

ıra J. Duffy
ss Litigation

ael D. Dwyer
ss & Real Estate

es R. Ekberg
ss Bankruptcy & Litigation

A. Englund
:x Class Action Litigation

Larry S. Gangnes
Business & Securities Litigation

Mary Jo Heston
Business Bankruptcy & Litigation

Charles C. Huber
Civil Litigation Defense

Bruce W. Leaverton
Business Bankruptcy & Litigation

Gail E. Mautner
Labor & Employment

Barry N. Mesher
Product Liability & Mass Tort Liability

Michael E. Morgan
Securities & Corporate Finance

Jane R. Nelson
Real Estate & Retail

D. Michael Reilly
Labor & Employment

Charles W. Riley, Jr.
Trusts & Estates

Michael H. Runyan
Product Liability & Insurance Litigation

James B. Stoetzer
Business & Intellectual Property Litigation

Gary P. Tober
Tax

From: Washington Law & Politics, Summer 2007

APPENDIX D

378 9/9/2008 6900157

08-2-12231-5 30484619 CMP 09-09-08

FILED
IN COUNTY CLERK'S OFFICE

A.M. SEP - 8 2008 P.M.

PIERCE COUNTY, WASHINGTON
KEVIN STOCK, County Clerk
BY__________ DEPUTY

IN THE SUPERIOR COURT FOR THE STATE OF WASHINGTON

FOR PIERCE COUNTY

Edward and Carol Brown, husband and wife, Michael Heutmaker and Marijean Heutmaker husband and wife as sole shareholders of TNX America Corporation a dissolved Washington Corporation, Phillip L. Austin, Mallia M. Booi, and Unclaimed Funds Inc., a Washington Corporation Plaintiffs, v. Pierce County Washington, a subdivision of the State of Washington, Defendants.	08 2 12231 5 CAUSE NO. **COMPLAINT**

COMES NOW Plaintiffs and complains against Defendant as follows:

1. Defendant Pierce County is a legal subdivision of the State of Washington.
2. Edward Brown and Carol Brown were the owners of Pierce County Tax Parcel 03-20-13-3-050 which real property was sold by Defendant,

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F:\Sandybackup\Alicia\Moe\Booi\Complaint

ORIGINAL

Pierce County for delinquent taxes pursuant to RCW 84.64.080 on or about December 8, 2000 and as a result of said sale Pierce County wrongfully withholds an overage of $6,344.56 belonging to said Plaintiffs.

3. Michael Heutmaker and Marijean Heutmaker are husband and wife and were at all times the sole shareholders and sole offices of TNX America Corporation, a now defunct Washington Corporation that was the owner of Pierce County Tax Parcel #700000820 which was foreclosed and sold for taxes pursuant to RCW 84.64.080 in or about December 1999 and as a result of said sale, Pierce County wrongfully withholds an overage of $25,844.01.

4. Philip Austin was the owner of Pierce County Tax Parcels #693640-087-0 and Pierce County Tax Parcel #693640-088-0 which were foreclosed and sold for taxes pursuant to RCW 84.64.080 in or about December 2002 and as a result of said sale, Pierce County wrongfully withholds an overage of $23,998.79.

5. Mallia M. Booi was the owner of Pierce County Tax Parcels #0220072065, 0220076003, 0220076004, 0220076005, 0220076606 which were foreclosed and sold for taxes pursuant to RCW 84.64.080 on or about December 1996 and as a result of said sales, Pierce County wrongfully withholds an overage of $162,026.14.

6. All of the above plaintiffs have made partial assignments of their interests in the said arrearages to Unclaimed Funds, Inc. a Washington

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Corporation having paid all fees and obtained all necessary licenses to do business in the state of Washington.

7. The above named Plaintiffs have filed claims with Pierce county Washington to have the above described arrearages paid over to them pursuant to law.

8. Pierce County Washington refuses and continues to refuse to pay the funds over to said Plaintiffs, and is wrongfully retaining said funds which are the property of the Plaintiffs.

Wherefore Plaintiffs Pray for Judgment as follows:

1. A Judgment requiring Pierce County Washington to pay over the Plaintiffs the amounts wrongfully withheld together with interest accrued at the rate 12% per annum from the date of the respective sales

2. Plaintiff's reasonable attorney's fees and costs incurred herein.

3. For such further and other relief as the Court deems equitable in the premises.

DATED this 3 day of September 2008.

MOE BIRNBAUM
Attorney for Plaintiff
W.S.B.A .#6783

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