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LEGAL THEORY

"I'LL SELL IT TO YOU AT COST": LEGAL METHODS TO PROMOTE RETAIL MARKUP DISCLOSURE

*Ian Ayres**
*and F. Clayton Miller***

In today's marketplace, retailers provide consumers with a wealth of information about the prices, qualities, and uses of their products. Conspicuously absent, however, is information about the retailer's cost or markup.[1] Retail sellers are generally unwilling to tell a buyer the wholesale cost of the goods they sell. To be sure, there are counter-examples. Some car dealers, for instance, promise to sell their cars for "$1 over dealer's cost."[2] Yet, because such representations are almost certainly false,[3] these very examples serve only to highlight the problem. In a limited number of markets, consumers value cost information but the competitive market process does not provide it in any credible fashion.

This Article examines whether consumer protection laws should be used to promote markup disclosure. Our goals are (1) to identify the

* Assistant Professor of Law, Northwestern University. B.A., J.D., Yale University; Ph.D., Massachusetts Institute of Technology

** Associate, Sherman and Sterling. B.A., University of Michigan; J.D., Northwestern University.

[1] The markup is the difference between retail price and retail cost. As discussed in note 98, *infra*, retail cost could properly be defined to include various overhead expenses, but as used here and throughout the rest of the Article, retail cost refers only to the marginal cost of the good, as represented by the per unit amount paid by the retailer to the manufacturer. *See also infra* note 112 (discussion of rebates).

The Lerner index of market power can also be calculated from the retail price and marginal cost data. The index is defined as the price of the good the firm produces less the marginal cost of that good divided by the price of that good, [(P-MC)/P]. The Lerner index is used in some economic models as a measure of market power. *See* Landes & Posner, *Market Power in Antitrust Cases*, 94 HARV. L. REV. 937 (1981); *see also* Lerner, *The Concept of Monopoly and the Measurement of Monopoly Power*, 1 REV. ECON. STUD. 157 (1934).

[2] *See, e.g.*, Chicago Tribune, Sept. 1, 1988, § 6, at 21, col. 1 (advertisement for Laurel Mazda-Volkswagen); *see also* DISCOVERY, June 1988, at 85 ("We plan to Lose Money on this Offer") (advertisement).

[3] For empirical evidence of car dealer cost misrepresentation, see *infra* note 39 and accompanying text.

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markets in which consumers will most value markup information; (2) to show how markup competition could increase equity and efficiency by decreasing retail price dispersion and by substituting for consumer search; and (3) to suggest why competitive markets might not supply the information that consumers and society value.

Even if we achieve these goals, it does not necessarily follow that the government should intervene. Government intervention in even inefficient markets is only rationally justified if it does more good than harm. Keeping this premise in mind, we explore a range of possible government interventions and assess the costs and benefits of supplementing or displacing market forces. We prefer the rifle to the shotgun. Our policy proposals are aimed at a small, but significant, group of retail markets where we believe some forms of government intervention are justified.

The retail car market serves as a paradigmatic example for many of our theories.[4] We suggest that buying a new car would be easier and more equitable in a world where retailers revealed their true costs. Consumers armed with information about the retailer's markup would not need to search at as many dealerships—for the simple reason that consumers would have a much better idea when they were getting a good deal. Markup information can thus serve as a dramatic substitute for consumer search.[5] We also suggest that markup revelation would truncate the bargaining process at each dealership. The possibility of hoodwinking uninformed buyers into purchasing at a high markup would diminish as the excessive profits would be directly revealed. There would most likely be fewer rounds of bargaining and less price dispersion in the final offers. Finally, we imagine that retailers might begin to compete on the basis of markups. Retailers might advertise not to sell cars above a certain markup level.[6] The dual burden of this Article is to explain how this "kinder, gentler" equilibrium could exist, and why market forces have failed to create it.

In Section I we discuss the evolution of the legal attitudes toward cost disclosure, beginning with the common law's indifference to intentional misrepresentation of seller's cost (while noting the increasing legal recognition of its relevance to informed consumer choice). Section II identifies the market conditions that make cost or markup disclosure rel-

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[4] Even if our proposal was limited exclusively to new car sales it would still merit the effort. More than $100 billion was spent on new cars in America in 1986. STATISTICAL ABSTRACT OF THE UNITED STATES 426 (1989) (chart No. 693). New car purchases represent the largest consumer investment for most U.S. citizens besides buying a house. *Id.*

[5] Search substitutes and search complements reduce the cost of consumer search by making consumer product search more efficient. *See* Grady, *Regulating Information: Advertising Overview*, in THE FEDERAL TRADE COMMISSION SINCE 1970: ECONOMIC REGULATION AND BUREAUCRATIC BEHAVIOR 222 (R. Clarkson & T. Muris eds. 1981).

[6] The intricacies of implementing mandated disclosure of the retail markup, including the difficulties of handling trade-ins and manufacturer rebates to the dealerships, are discussed in notes 113-117, *infra*.

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evant to buyers. In "thick" markets, such as the New York Stock Exchange, current price quotations are cheaply available, making seller cost immaterial. In "thin" markets, however, where this information is not so easily acquired, consumers may rationally value markup information. Section III explains why retail competition fails to provide this information about seller cost. Focusing on these sources of market failure, the fourth and final Section examines a range of ways that government might intervene to promote cost disclosure—including increased enforcement of prohibitions against markup misrepresentations, development of accounting standards to allow retailers to speak more credibly about their costs, and implementation of guidelines mandating disclosure of the retailer's costs or markups in appropriate markets.

I. THE LEGAL LANDSCAPE

The common law has traditionally been reluctant to penalize sellers for misrepresenting their costs. Even as recently as the first half of this century, a seller's cost misrepresentation was not, standing by itself, actionable as a fraudulent misrepresentation of a material fact.[7] For example, in *Furrow v. 1st National Bank of Oklahoma City*,[8] the Oklahoma Supreme Court refused to allow a buyer to sue for fraudulent misrepresentation when the seller had misrepresented what the land had cost. In that case, "misrepresentation by the seller as to both the value of the property to the plaintiffs and the amount paid by the defendants was not sufficient as a matter of law to go to the jury."[9]

Other jurisdictions have similarly held that the misrepresentation of seller's cost was immaterial to the current valuation of property, or that the buyer did not in fact rely on the misrepresentation.[10] These decisions

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[7] *See, e.g.*, Steiner v. Hughes, 172 Okla. 268, 271-72, 44 P.2d 857, 860-61 (1935) (misrepresenting cost of stock to the seller is irrelevant, standing alone, and does not constitute fraudulent misrepresentation); Rogers v. Brummett, 92 Okla. 216, 219-20, 220 P. 362, 366 (1923) (false statement as to the value of the property, standing alone, is not actionable as fraud, though "[i]f the false statement as to the value of the property is one act of a series of fraudulent acts" designed to induce the purchaser to buy, "the false statements as to the value will be considered as one of the elements to actionable fraud"); *see also* Hawk v. Brownell, 120 Ill. 161, 163-64, 11 N.E. 416, 416-17 (1887) (absent a fiduciary or similar relationship between buyer and seller, the misrepresentation of original cost to seller is not by itself fraudulent); Beare v. Wright, 14 N.D. 26, 37, 103 N.W. 632, 636 (1905) (cost misrepresentation does not constitute actionable fraud in the absence of fiduciary duty between the parties or other circumstances that give rise to an agreement that the cost should determine the price of the contract); Robinson v. Phegley, 84 Or. 124, 129, 163 P. 1166, 1167 (1917) (misrepresentation as to the value of claims against a certain property was immaterial).

[8] 133 Okla. 137, 139-40, 271 P. 632, 634 (1928) (misrepresentation of seller's cost was not relevant as it had no material bearing on the current value of the property).

[9] *Id.*

[10] *See, e.g.*, *Hawk*, 120 Ill. at 161, 11 N.E. at 416 (misrepresentation about cost does not constitute fraud unless a fiduciary relationship exists between buyer and seller); *Steiner*, 172 Okla. at 270, 44 P.2d at 860 (statements made about the original cost of the stock to the seller regarded "as pure 'dealer's talk' "; court did not find "sufficient materiality, or proof of reliance upon them. . ."");

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were premised on the proposition that buyer reliance on the seller's purported cost in figuring the price she was willing to pay was unreasonable absent something more specifically fraudulent.[11] These jurisdictions placed the burden on the buyer to determine independently the value of the property at the time of the sale. For example, in *McCaw v. O'Malley*,[12] the Missouri Supreme Court denied a buyer's fraud claim when a seller had misrepresented his cost in a real estate transaction:

> The mere statement by the vendor of what an article cost him would not be regarded as a matter on which a vendee should rely where, as here, the vendee had an unrestricted opportunity to learn the actual value of the property and where, as here, the vendee actually undertook to ascertain such value.[13]

By denying buyers an action of fraud for a seller's misrepresentation of cost, the common law seriously undermined the ability of buyers to acquire reliable cost information. That is, the reliability of any cost representation would have been substantially discounted by buyers, because under the common law sellers had no legal obligation to tell the truth.[14] Moreover, the *McCaw* standard explicitly precluded buyers from relying on the seller's cost information as a substitute for independently searching out the property's current value. If the buyer had "an unrestricted opportunity to learn the actual value of the property" independently, she could not rely on the seller's cost as a search substitute.

This independent valuation method held sway until the 1950s, particularly in the Western states where it was tied to the long-standing

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Rogers, 92 Okla. at 216, 220 P. at 362 (mere statements as to what the property is worth, whether reflective of cost or some subjective value, not actionable as fraud unless there are other actions that mislead the buyer and would reasonably require him to base his decision on the seller's opinion or statements); Bryant v. Stohn, 260 S.W.2d 77, 82-83 (Tex. Civ. App. 1953) (cost misrepresentation not actionable unless the price paid by the vendee was specifically tied to the misrepresented cost).

[11] *See, e.g.*, Furrow v. 1st Nat'l Bank of Oklahoma City, 133 Okla. 137, 139-40, 271 P. 632, 634 (1928) (misrepresentation by the seller as to the value of the property to the plaintiffs and the amount paid by the defendants was not sufficient as a matter of law to go to the jury as a question of law); *Robinson*, 84 Or. at 129, 163 P. at 1168 (buyer alleged purchase made in reliance on the defendant's representations of his cost; court held that "[i]t is not enough that the misrepresentations of a vendor furnishes the vendee with a motive to buy"); *see also* D.C. Land & Bldg. Co. v. McInerney, 64 F.2d 554, 555 (D.C. Cir. 1933) (misrepresentation of cost did not constitute fraud; inappropriate for buyer to base his judgment solely on that information); Orlan v. Laederich, 338 Mo. 783, 793-94, 92 S.W.2d 190, 196 (1936) ("[t]he exercise of common sense, self-reliance, and ordinary diligence and prudence is to be expected in. . . transactions between adults, and indolence, listlessness, indifference, and unwarranted credulity should not be encouraged."); McCaw v. O'Malley, 298 Mo. 401, 415, 249 S.W. 41, 45 (1923) (purchaser should not ordinarily rely upon representations of cost particularly when purchaser had "an opportunity to determine value.").

[12] 298 Mo. at 401, 249 S.W. at 45 (1923).

[13] *Id.* at 401, 249 S.W. at 45; *see also* Orlan v. Laederich, 338 Mo. 783, 793-94, 92 S.W.2d 190, 197 (1936) (buyer had ample opportunity to inspect property and ascertain value).

[14] Of course, the sellers may have had reputational or ethical incentives to tell the truth, even without the potential of fraud actions.

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doctrine of "caveat emptor."[15] Since that time, however, several jurisdictions have adopted a broader concept of materiality and reasonableness of reliance.[16] Some courts have begun now to infer reasonable reliance by the buyer on a seller's representation of cost.[17] Yet, the narrow common-law rules from cases like *Furrow* and *McCaw* have not been overruled and show surprising resiliency. For example, a Missouri appellate court, as recently as 1986, reaffirmed the *McCaw* holding when it refused to allow plaintiffs to rescind a real estate contract even though the defendant admitted to overstating his cost by $10,000.[18]

While the common law has only grudgingly started to accept the relevancy of seller's costs to buyers, federal and state regulations have begun to prohibit cost misrepresentation and, in a few areas, actually mandate partial cost revelation. The Federal Trade Commission has, for example, promulgated a set of *Guidelines Against Deceptive Pricing*,[19] which strictly limits the representations individual sellers may make concerning the cost of the goods: "[R]etailers should not advertise a retail price as a 'wholesale' price. They should not represent that they are selling at 'factory' prices when they are not selling at the prices paid by those purchasing directly from the manufacturer."[20] Additionally, the *Guidelines* limit advertising of the seller's cost as below or equal to "invoice" or "market" cost without proper justification. The *Guidelines* clearly repre-

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15 *See, e.g.*, Bryant v. Stohn, 260 S.W.2d 77, 82-83 (Tex. Civ. App. 1953) (vendor's misrepresentation of rents to be recovered from purchased land was not actionable fraud); *see also* Steiner v. Hughes, 172 Okl. 286, 44 P.2d 857 (1935).

16 *See, e.g.*, Vertes v. GAC Properties, Inc., 337 F. Supp. 256, 260 (S.D. Fla. 1972) (To constitute "actionable fraud," it must appear that the defendant made a material misrepresentation; that it was false; that when he made it he knew it was false, or made it recklessly without knowledge of its truth as a positive assertion; that he made it with the intention that it should be acted on by the plaintiff; that plaintiff acted in reliance on it; and that the plaintiff was actually injured.).

17 FDIC v. Palermo, 815 F.2d 1329, 1337 (10th Cir. 1987) (misrepresentations by bank officers were actionable; plaintiff was reasonable in assessing the value of the property on the basis of the money the bank was willing to let the plaintiff secure and that due to the uncertain value of the property the bank's valuation was as good as any other valuation available to the plaintiff); *see also* Alexander v. Sagehorn, 600 S.W.2d 198, 201 (Mo. Ct. App. 1980) (fraud claim permitted when wife relied on husband's misrepresentation of property value in divorce settlement); Rimling v. Scherper, 206 Wis. 532, 545, 240 N.W. 159, 164 (1932) (misrepresentations "well calculated to induce anyone intending to purchase not to make direct inquiry of the owners"; plaintiff thus reasonably relied on the seller's statements).

18 Misskelly v. Rogers, 721 S.W.2d 170, 173 (Mo. Ct. App. 1986) (court found that the plaintiffs investigated the property prior to purchase and as such it was unreasonable for them to rely on the seller's representation of cost as a basis for a value judgment); *see also Palermo*, 815 F.2d 1329 (federal court at pains to distinguish prior state precedent).

19 16 C.F.R. § 233 (1989) [hereinafter *Guidelines*].

20 *Id.* at § 233.5 (1989). Although the FTC has not to date brought suit claiming that a misrepresentation of seller's cost is an unfair trade practice, the *Guidelines* are explicitly intended to be read broadly: "The practices covered in the provisions set forth above represent the most frequently employed forms of bargain advertising. However, there are many variations which appear from time to time and which are, in the main, controlled by the same general principles." *Id.*

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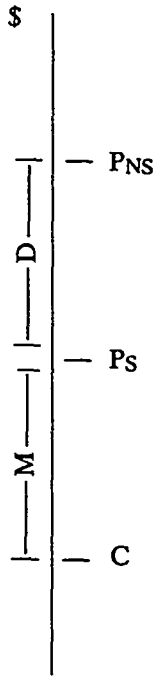
sent an attempt to protect consumer welfare by prohibiting cost misrepresentations by sellers.

More generally, the *Guidelines* prohibit sellers from misrepresenting nonsale prices. For example, it would be deceptive to advertise: "Widgets, normally $20 a bunch, now only $12" if the normal (nonsale) widget price was actually less than $20. The ultimate question for the consumer is whether the widget is worth $12.[21] The motive underlying the "was $20, now $12" deception is that consumers are more likely to think a widget is worth $12 if they hear that it is regularly sold for $20 instead of for, say, $15. The *Guidelines* attempt to prohibit sellers from giving false indirect indicators of widget value in two distinct ways. The deceptive sale rules prohibit sellers from overstating the size of the sale discount ("up to 50% off"); the deceptive cost rules—operating at a different margin—prohibit sellers from understating the true markup ("only 5% over our cost"). As illustrated in Figure 1, the deceptive cost and markup rules attempt to do from below what the deceptive sale and discount rules try to do from above. Both rules implicitly recognize that consumers may misjudge whether the product is worth the current price if they are given benchmarks of false, nonsale prices or false seller costs. The rules express the belief that inflated discount or deflated markup claims may mislead some consumers into making mistaken purchases.

[21] *See infra* note 44 and accompanying text for a fuller discussion of the determinants of consumer choice.

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Figure 1



P_{NS} = Non-sale (normal) Widget Price
P_S = Sale (current) Widget Price
C = Seller Cost
M = Total Market = $P_S - C$
D = Total Discount = $P_{NS} - P_S$
m = Percentage Markup = $\frac{P_S - C}{C}$
d = Percentage Discount = $\frac{P_S}{P_{NS}}$

Most states have passed similar unfair trade practices acts or consumer protection statutes to address seller misrepresentation.[22] These statutes generally prohibit any misrepresentation that has "a tendency to mislead."[23] A typical example of this type of statutory provision that draws upon the consensus of state law is found in the District of Columbia's Unfair Trade Practices statute.[24] Sections 28-3904(e) and (j) make

22 *See, e.g.*, MASS. GEN. LAWS ANN. ch. 93A, § 1 (West 1989).
23 *See generally supra* note 22, for the language in the state statutes noted previously.
24 D.C. CODE ANN. § 28-3904 (1989).

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it unlawful for sellers to:

> (e) misrepresent as to a material fact which has a tendency to mislead; . . . or
>
> (j) make false or misleading representations of fact concerning the reasons for, existence of, or amounts of price reductions, or the price in comparison to the price of competitors or one's own price at a past or future time.[25]

These kinds of statutes are frequently used to attack a broad range of seller misrepresentations.[26] Like the FTC's *Guidelines*, state statutes significantly restrict the de jure right of sellers to misrepresent their costs or markup.

In a handful of settings, state and federal regulations even mandate certain types of cost disclosure. For example, the Automobile Information Disclosure Act[27] mandates that retailers disclose their transportation, shipping, and delivery costs.[28] In the corporate context, Congress has empowered the Securities and Exchange Commission to require, via

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25 *Id.*

26 *See, e.g.*, Barry v. Arrow Pontiac, Inc., 100 N.J. 57, 494 A.2d 804 (1985) (brought under New Jersey's Consumer Fraud Act, N.J. Stat. Ann. §§ 56:8-1 to :8-38 (West 1989)); Guste v. Crossroads Gallery Inc., 357 So. 2d 1381 (La. Ct. App. 1978) (brought under Louisiana's Unfair Trade Practices in Consumer Protection Act, La. Rev. Stat. Ann. §§ 51:1401-:1418 (West 1987)); F. Ray Moore Oil Co. v. State, 80 N.C. App. 139, 341 S.E.2d 371 (1986) (brought under North Carolina's Consumer Protection Statute, N.C. Gen. Stat. § 75-16 (1988)), *review denied*, 317 N.C. 333, 346 S.E.2d 139 (1986). *See generally* Annotation, *Practices Forbidden by State Deceptive Trade Practice and Consumer Protection Acts*, 89 A.L.R.3D 449 (1979 & Supp. 1989) (more complete listing of similar cases arising under the several state consumer protection statutes).

27 15 U.S.C. §§ 1231-1233 (1988).

28 The Automobile Information Disclosure Act (or the "Act") requires that:

> Every manufacturer of new automobiles distributed in commerce shall . . . securely affix to the windshield . . .
>
> (f) the following information:
>
> (1) the retail price of such automobile suggested by the manufacturer;
>
> (2) the retail delivered price suggested by the manufacturer for each accessory or item of optional equipment, physically attached to such automobile at the time of its delivery to such dealer, which is not included within the price of such automobile as stated pursuant to paragraph (1);
>
> (3) the amount charged, if any, to such dealer for the transportation of such automobile to the location at which it is delivered to such dealer;
>
> (4) the total of the amounts specified pursuant to paragraphs (1), (2), and (3).

15 U.S.C. § 1232 (1988).

The Act carries with it fines of up to $1000 for each offense. By mandating disclosure, Congress hoped to deter dishonest and confusing marketing strategies:

> Recently, the new car dealers have been plagued by unfair and unscrupulous marketing practices on the part of some dealers, which have been injurious to the new car dealers as a whole, injurious to the car manufacturers, and bewildering to the purchasers of new cars. These practices are what is called 'price packing' and misleading advertising. They have created chaos and confusion in the market place.
>
> Price packing is the practice of marking up or adding charges over and above the normal recognized markup from the wholesale price at which a dealer purchases a new automobile from a manufacturer. The pack in the price of a new car is, of course, offset by overallowances on the trade-in value of the customer's used car. The effect has been to confuse the public and to damage the automobile industry. Dealers who would like to do business on a fair, competitive basis have been forced to use such tactics in order to stay in business. Confusion, doubt, and suspicion have developed in the minds of the buying pubic which have retarded the sale of new

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statute and regulation, that corporate directors, officers, promoters or employees disclose the costs of any property sold to the corporation.[29] And some statutes require disclosure of cost for specific types of products or services, such as automobile repair costs,[30] real estate closing costs,[31] and funeral goods and services costs.[32]

Over the last half century the common-law approach to seller cost or markup disclosure has come into increasing conflict with the federal and state regulations. Our common-law traditions have held that information about seller's cost should largely be irrelevant to a rational consumer; in contrast, regulations at both the state and federal levels implicitly recognize that markup misrepresentations can deceive buyers, and in a few, limited markets, these regulations have required disclosure of particular costs. Legislators and jurists both recognize that seller's cost can play an important role in consumer determination of value and have endeavored to acknowledge this fact.

The conflict between the old and the new law leads us to ask which is right. We now strive to answer whether rational consumers should care about seller's cost. Our answer: "It depends."[33] In the next Section, we delineate market conditions that will cause consumers to value or ignore markup information.

II. Do Consumers Value Markup Information?

We begin by following Wittgenstein's advice: "don't think, but look."[34] Empirically, it is fair to say that at least some consumers in some markets value markup information. In the retail car market, for example, many consumers pay third-party services, like *Consumer Reports* or *Edmunds*, for estimates of dealer costs.[35] In addition, the fraud

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cars, and have set off a chain reaction adversely affecting the entire automobile industry, and, in fact, our entire economy.

1958 U.S. Code Cong. & Admin. News 2903.

29 Securities Act of 1933, 15 U.S.C. § 77a (1989) (particularly 7 and 10, requiring registration statements of all new securities and paragraphs 20, 21, and 25 of Schedule A, requiring disclosure in the registration statements of all sales of property to the corporation; *see also* Item 302 & Reg. S-K (17 C.F.R. §§ 229 *et seq.* (1989)); Forms 10Q & 10K and 13(d) and 15(d) of the Securities Exchange Act of 1934, 15 U.S.C. § 78(a) *et seq.* (1988).

30 *See, e.g.*, Cal. Bus. & Prof. Code 9880 (West 1989).

31 *See, e.g., id.* at 10,140, 10,236.

32 16 C.F.R. § 453.2. The funeral provider must furnish prices of certain products or services. These include "the price of embalming, transportation of remains, use of facilities, caskets, outer burial containers, immediate burials, or direct cremations. . . ." *Id.* at 320-21.

33 This classic conclusion of legal scholarship can be found in many texts. Our favorite is Haddock & Macey, *A Coasian Model of Insider Trading*, 80 Nw. U.L. Rev. 1449, 1467 (1986).

34 L. Wittgenstein, Philosophical Investigations § 66, at 31 (G. Anscombe trans 3d ed. 1968).

35 *Consumer Reports* charges $11 for the first estimate, $9 for the second, and $7 for each additional estimate. It does not keep records of how many consumers use this service. Each *Edmunds* book includes estimates of many types of cars (*e.g.*, foreign or compact) for a suggested retail price of

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cases already discussed are themselves anecdotal evidence that in some settings buyers and sellers value information about the seller's costs.

Although most consumers of most goods do not attempt to obtain markup information either directly from the seller or from third-party sources, this fact by itself does not conclusively show that consumers don't value cost information.[36] Rather, the failure to ask for cost information may itself be a product of other influences that dissuade consumers from seeking such information despite its inherent value. For example, the cost of third-party estimates may make services like *Consumer Reports'* dealer cost estimates impractical for less expensive consumer goods (like toasters). In addition, the fact that buyers don't ask for markup information may be as much a function of the seller's unwillingness to disclose such information. It would be rather futile, for example, to ask a salesperson at Sears about the markup on a particular item.[37]

Explaining consumer silence by seller resistance is supported by a recent study of Chicago car dealerships. Consumer-testers bargaining for a new car asked salespeople about the dealership's true cost, among other things. The test results affirm the hypothesis that sellers are unwilling to reveal such cost information.[38] In every instance salespeople either refused to provide cost information or gave an inflated figure for dealer cost. Sixty-eight percent of the salespeople simply refused to provide the cost information requested. In the remaining thirty-two percent where salespeople did disclose cost, they inflated the figures an average of eight percent, or $870, above the actual dealer cost.[39]

$5.95 per book; approximately 186,000 copies were sold in 1989. Other third-party organizations provide similar services to their members. For example, USAA, an association of current and former U.S. military officers, will provide estimates of dealer costs to its members for $8.95 per car. Indeed, USAA even advertises a service that "negotiate[s] the best price" for a car at any dealership. Anecdotal evidence from individual car dealers, however, suggests that fewer than 50% of car customers have third-party information concerning dealer costs.

36 Of course, this fact also does not prove that they value markup information. Indeed, we present a theory, *infra* notes 42-48 and accompanying text, that suggests that rational consumers will rationally ignore or be indifferent to markup information in many markets. This is especially true when consumers make repeated purchases of goods in "thick" markets with well-established spot prices. *See infra* note 43 and accompanying text (definition of "thick" market).

37 Of course, it is unlikely that any salesperson at a store like Sears would possess cost information, because of the structure of the store and sales process involved. As little or no bargaining is done at a Sears, the sales staff would have little reason to know what the marginal cost or the markup of the product is. This structure keeps such cost and markup information in the hands of top management and prevents the sales help from revealing it even if they were so inclined.

38 As opposed to the earlier Sears example, car salespeople do possess the kind of cost information useful to the consumer. Because automobiles are a classic "bargain good" in the consumer market, salespeople must have access to and knowledge of cost information in order to formulate an effective bargaining strategy. As such, it follows that in the new car market the failure to reveal the cost information requested stems not from an inability, but rather an unwillingness, to do so.

39 Ayres, *Fair Driving: Race and Gender Discrimination in New Car Sales*, 104 HARV. L. REV. (forthcoming 1991).

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Moreover, evidence from several markets suggests that the more market power the buyer possesses, the more likely it is that the parties will contract for markup disclosure. The monopsonist buyer, not having to overcome any collective action problem, can bargain better than unconcentrated groups of buyers. Often the first thing a monopsonist bargains for is information about the seller's costs. Countries, for example, have significant purchasing power in some product markets. When the U.S. government solicits bids for government contracts, it requires bidders to put down estimates of their cost.[40] Similarly, member states of the United Nations have joined together to force transnational drug companies to disclose their markups as a prerequisite to bidding on state contracts.[41]

This is not to suggest empirically that all consumers would want markup information in all markets. It is suggested, however, that enough buyers expend real resources to learn about seller markups that the common law's strong claim that markups are immaterial can be empirically rejected. Our next task is to provide a theory to explain why some buyers want to know the seller's cost.

A. The Irrelevance of Seller's Cost in Thick Markets

There is a certain logic in thinking that consumers would ignore the seller's cost in determining the value of a good. Economic theory suggests that a rational consumer would instead focus solely on whether the good was worth the seller's price.[42] Knowing the market price of similar goods is crucial to assessing the good's worth because forgoing the purchase of a similar product is an "opportunity cost" of making any purchase. A consumer wouldn't want to a buy a good that she could buy more cheaply elsewhere. The seller's historic costs can be irrelevant to this "opportunity cost" inquiry when there are independent measures of the good's market value. For example, in "thick" markets for homogeneous products a current market (or "spot") price will be readily avail-

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40 Prime contractors must provide cost and pricing data to the federal government when submitting contracting bids for government work. Truth-in-Negotiations Act, 10 U.S.C. § 2306(a) (1989).

41 Via the World Health Organization (WHO) and other multinational groups under the umbrella of the United Nations (such as the United Nations Action Programme for Economic Cooperation Among Non-Aligned and Other Developing Countries (UNAPEC), the United Nations Action Programme For Essential Drugs (UNAPED), and United Nations Independent Development Organization (UNIDO), developing third world countries have attempted, sometimes successfully, to force transnational pharmaceutical companies to make bulk sales to the WHO and the various agencies named above while disclosing cost, thus ensuring both pricing and quality efficiency. *See* U.N. CENTRE ON TRANSNAT'L CORPS., TRANSNATIONAL CORPORATIONS IN THE PHARMACEUTICAL INDUSTRY OF DEVELOPING COUNTRIES, at 60-84, U.N. Sales No. E.II.A.10 (1984).

42 Microeconomic theories of consumer choice suggest that rational consumers will form "reservation" prices, which reflect their subjective value of a good, and will purchase the good whenever their reservation price is above the good's market price. *See* H. VARION, MICROECONOMIC ANALYSIS 104 (1978).

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able.[43] In thick markets, therefore, consumers would not rely on seller's costs as an indication of market value, because there are better, independent measures—namely, the market price.[44]

A quintessential example of such a thick market, where seller's cost should have no relevance, is the New York Stock Exchange. This insight underlies the Efficient Capital Markets theory.[45] The "weak form" of the Efficient Capital Markets hypothesis predicts that past stock prices will be unrelated to future changes in price.[46] Because all information about past prices is reflected in the current market price (and indicates nothing about future price changes), rational consumers would ignore information about the seller's cost. It should be irrelevant to someone buying IBM at $100 a share today whether the seller bought it for $50 or $150 a share last week. Because the informational content of past prices is incorporated into the current price, knowledge of past prices is not valuable to rational consumers in thick markets.[47]

There are other ready examples of thick markets which generate well-defined spot prices. Commodities such as wheat, oil, gold, and any other good traded on the New York Commodity Exchange or the Chicago Board of Trade qualify as such goods. Product homogeneity and sufficiently large numbers of buyers and sellers are prerequisites to market "thickness." It is impossible to develop a thick market for non-homogeneous goods, such as Persian rugs, because a spot price could

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43 A thick market is one in which parties publicly trade so many homogeneous products that a well-developed spot price is readily available. *See* O. WILLIAMSON, MARKETS & HIERARCHIES, ANALYSIS & ANTITRUST IMPLICATIONS: A STUDY IN THE ECONOMICS OF INTERNAL ORGANIZATION 143 (1975).

44 Consumers will have to compare their subjective value to the market price even in thick markets. But their subjective value of the good should normally be independent of the seller's. Therefore, if seller's cost is going to be relevant to consumers, it will be through the nexus with "opportunity cost."

45 *See* Fischel, *The Efficient Capital Market Hypothesis, Economic Theory and Regulation of the Securities Industry*, 29 STAN. L. REV. 1031, 1041-1054 (1977); Fischel, *Efficient Capital Market Theory, The Market for Corporate Control and the Regulation of Cash Tender Offers*, 57 TEX. L. REV. 1 (1978). In legal terms, information about seller's cost would not be material. This fact was established by the Supreme Court in the context of securities trading. *See* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438 (1976) ("An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote."). The immateriality doctrine was reaffirmed in the Court's adoption of the "Fraud on the Market theory." *See* Basic, Inc. v. Levinson, 485 U.S 224 (1988).

46 Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. FIN. 383 (1970).

47 It should be noted that even in thick stock markets, the irrationality of *chartism* persists, whereby some stock-market consumers quixotically attempt to predict future prices by charting the past price cycles. R. BREALY & S. MYERS, PRINCIPLES IN CORPORATE FINANCE 260-61 (1981). However, even if one rejects the Efficient Capital Markets hypothesis, *see, e.g.*, De Bondt & Thaler, *A Mean-Reverting Walk Down Wall Street*, 3 J. ECON. PERSP. 189 (1989), knowledge of a specific seller's past price is immaterial because the historic spot price is available from other sources. Knowing a specific seller's cost adds little over knowing what the stock in general was selling for that day.

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never apply across goods. And the requirement of multiple transactions insures that the spot price will continuously reflect changes in market conditions. It is not surprising, therefore, that many of our thickest markets also have a sizable secondary market that even further increases the effective number of buyers and sellers of the commodity.

Homogeneity and multiple transactions are necessary but not sufficient conditions for market thickness. Returning to our automobile paradigm, we find that even relatively homogeneous products and numerous dealerships do not insure a well-defined or readily available spot price for new cars. Consumers pay dramatically different prices for the same car, and need to invest significant amounts of time just trying to determine what the "real" price is.[48]

Consumers buy in retail markets that vary dramatically in their thickness. Indeed, many products are sold to consumers in relatively thin markets. Goods that consumers buy infrequently—such as consumer durables—or goods which are inherently idiosyncratic—such as houses and used cars—will often be traded in markets without well-defined or readily available spot prices. Markets in which the good's price must be bargained for—such as automobiles, electronics equipment, and bicycles—are likely to be especially thin.[49]

In thick markets, then, the common law correctly characterizes seller's cost to be immaterial to rational consumer choice. However, the common-law approach cannot be extended to thin markets.[50] We will show that in thin markets rational consumers may rationally rely on representations of seller's cost and, indeed, may have incentives to seek out such information.[51]

B. Markup Disclosure as Search Substitute

In a thin market—one in which a well-defined spot price is not readily available—consumers will rationally investigate the prices of similar

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[48] *See* Jung, *Price Variations Among Automobile Dealers in Chicago, Illinois*, 32 J. BUS. 315 (1959); Stigler, *Economics of Information*, 69 J. POL. ECON. 213 (1961), *reprinted in* G. STIGLER, THE ORGANIZATION OF INDUSTRY 171 (1968).

[49] In a thick market, bargaining would be useless because no seller will sell at a price lower than spot price, and no buyer will buy at a price higher than spot price.

[50] There is some indication that judges in common-law cases are beginning to appreciate the distinction between thick and thin markets. In *FDIC v. Palermo*, 815 F.2d 1329 (10th Cir. 1987), Judge James Logan found that a seller's misrepresentation was actionable in part because of the uncertain value of the property. This diverges from earlier Oklahoma law in which the speculative nature of the property was once the very basis for not finding reasonable reliance by the plaintiff buyer.

[51] Professors Haddock, McChesney, and Spiegel have suggested that legal rules should at times turn on the thickness of the market. Haddock, McChesney & Spiegel, *An Ordinary Economic Explanation of Extraordinary Legal Sanctions*, 78 CALIF. L. REV. (forthcoming 1990); *see also* Ayres & Gertner, *Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules*, 99 YALE L.J. 87 (1989).

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goods. In other words, when a spot price does not exist, rational consumers will try to create one.[52] It is in just these situations that knowledge of seller's cost can benefit the consumer. The seller's cost is evidence of what the spot price for the good *used to be*, and thus, in a thin market, may be a useful proxy in determining what the market price currently is.[53]

Knowledge of seller's cost can therefore enhance the efficiency of consumer search by reducing the time spent on comparison shopping and by increasing the effectiveness of any search undertaken. Seller cost disclosure reduces the search cost consumers must incur when they are looking for a product. By knowing the cost to the seller, the consumer is able to reduce her search cost by either substituting this information for more search or by using it as a complementary tool to help her more accurately evaluate the information the search generates. In either situation, the consumer gains.[54]

Seller cost will act as a substitute for actual search by the consumer if it reveals to consumers the likelihood of finding a better price elsewhere. For example, imagine that you are going out to buy a good that you seldom purchase—let's say a diamond. You come to a store that has just the type of diamond that you want, but you're unsure whether you are getting a reasonably competitive price—and you are trying to decide whether to visit other jewelry stores. If you knew that the store only added a five percent markup on the diamond, you would be less likely to search than if you knew that the store had added a fifty percent markup.[55] Examples like this dramatize the simple intuition that markup disclosure can aid consumers by giving them some information

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52 There is a rich economics literature detailing how long and how hard consumers will rationally search for competitive prices. *See, e.g.*, Stigler, *supra* note 48. Consumers will undertake additional search at least as long as the marginal gain (of an expected lower price) is perceived to be greater than the marginal cost (of going to another store).

53 Indeed, in the thinner market for over-the-counter stocks, the National Association of Securities Dealers has promulgated a "5% markup policy," which prohibits securities dealers from reselling a share of stock for more than a 5% markup. *NASD Manual*, par. 2151, § 1. *See also* R. TEWELES & E. BRADLEY, THE STOCK MARKET 198 (5th ed. 1987). Limiting the dealer markup reduces the investor's cost of interacting with dealers because they don't have to independently verify whether the dealer is trading at an artificially high price.

54 Through either the substitution or complementary effects, markup disclosure makes the consumer more efficient in her product search and retains the reduction in search cost as a consumer welfare efficiency gain. Search substitutes and search complements reduce consumer search by making consumer product search more efficient. *See* Grady, *supra* note 5, at 226.

55 It might be that a 5% markup still represents an supra-competitive profit (for example, if the competitive markup in the industry were only 1%). But the textual point is still correct that *other things being equal* consumers will be less likely to search if they know there is a lower markup. As emphasized below, *see infra* note 57 and accompanying text, consumers can often directly experience the quality of the retail services. They do not evaluate the markup information "in a vacuum." Given a certain amount of retail services, consumers will be better informed about how much to search if they know the size of the retail markup. If consumers have received retail services that should have cost the retailers 5%, they are much more likely to continue to search if they learn the

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on whether they have a good deal.[56]

This is not to say that five percent markups are always good deals. Retailers incur expenses in providing valuable services to consumers, and their markup on the diamond even in a competitive market will reflect the cost of these services.[57] But in many situations, the retail services will be a good that the consumers can directly experience.[58] Consumers can feel the thickness of the carpet in the showroom, can see how well dressed the salesperson is, and, in a sense, can gauge whether the markup is justified by these retail services.[59] At an extreme, if someone tries to sell a diamond out of the back of a truck, consumers should expect that there will not be a very large markup in a competitive market.

Consumers may value markup disclosure because markup disclosure transforms the retailer into the consumer's buying agent. Retailers have a powerful incentive to purchase goods at the lowest wholesale price. In that sense, consumers' and retailers' incentives are aligned: both want the retailer to buy at the lowest wholesale price.[60] Consumers can partially rely on this unity of interest in evaluating markup information. Since retailers have independent incentives to buy at a low wholesale price, consumers can rationally focus on whether the retailer's markup is reasonably low or not.[61]

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retailer is charging a 50% markup. If the consumers have received retail services that should cost the retailers only 1%, then news of a 5% markup might spur additional search.

56 The disclosure of seller's cost may also act as a complement to the consumer search that does occur. It may make the search more productive by giving the consumer a standard upon which to gauge and evaluate her results.

57 We assume the seller's cost to be just the marginal cost paid for the individual diamond and not any of the overhead costs, such as renting the retail space and advertising. *See supra* note 1.

58 Although the underlying product might be a search good, the retail services themselves may be experience goods. For a description and discussion of the distinction between experience and search goods, see Nelson, *Advertising as Information*, 82 J. POL. ECON. 729 (1974); *see also* Grady, *supra* note 5.

59 Some retail services (especially those occurring after the sale—like warranty repair) may be hard for consumers to experience at the time of sale. But reputational market constraints will largely control the seller's provision of these services with or without cost disclosure.

60 Their interests diverge on the subsequent issue of how large the retail markup should be. Retailers like a high markup; consumers like a low markup.

61 A rational consumer, however, would never completely rely on retailers to obtain the lowest wholesale price, because the more consumers rely on retailers to buy at the lowest price, the fewer incentives retailers will have to do so. If consumers focused exclusively on markup information in making their purchasing decisions, retailers would have no incentive to search for the best deal themselves. Thus, while markup disclosure may efficiently reduce consumer search, it may inefficiently reduce retailer search—insofar as the retailers may believe that they can pass on a higher wholesale price to the consumers as long as they do not excessively engage in markup of the retail price.

The deleterious effects of this extreme reliance do not, however, undermine the argument that markup disclosure can be efficient. As long as consumers don't focus solely on the markup, as long as they continue to pay attention to the retail price and undertake some search in equilibrium, retailers will retain strong incentives to search for the lowest wholesale price. This will be especially true for products where the wholesale price does not vary dramatically across retailers. Many manufac-

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Consumer search is an almost inevitable by-product of rational choice in thin markets. The "shoe-leather" costs of comparison shopping are real costs borne by society. This Section has shown that knowledge of markup disclosure is likely to reduce significantly the cost of search by letting consumers know more objectively when they have a good deal and can stop searching. Thus, in thin markets, consumers may rationally value such information to make their search for the market price more efficient.[62]

C. *Markup Knowledge Can Improve Consumer Bargaining Power*

Rational consumers may also value markup information in markets where they bargain over the sales price.[63] In bargaining markets, knowledge of a retailer's cost provides important information about how low a retailer may be willing to go. Since a retailer cannot survive in the long run if it sells goods at a loss, consumers realize that retailers will seldom be willing to sell goods at less than their cost.[64] Retailers may refuse to go this low, but knowledge of seller's cost at least lets consumers know when it is likely to be futile to continue bargaining. In this sense, markup information serves a role that is similar to its effect on consumer search. Just as markup information can tell consumers when it is time to stop searching, it can tell consumers when it is time to stop bargaining. The bargaining process itself can be seen as a type of intra-firm search by consumers for the best price.

In economic terms, the equilibria of bargaining games often are a function of each party's "threat point." The threat point is the price above or below which a party would prefer not to contract. For example,

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turers sell their products at uniform prices to retailers; the Robinson-Patman Act, in fact, places legal constraints on selling to different competitors at different prices. *See* 15 U.S.C. § 13 (1989).

62 Victor Goldberg has proposed an additional reason why markup disclosure might be efficiency enhancing. Under the Uniform Commercial Code § 2-708(2), a consumer breaching a purchase agreement may be liable to a retailer for the lost profits on the sale. If consumers do not know what the lost profit is—here the size of the markup—they cannot appropriately estimate the cost of exercising their option to breach and thus are likely to take inefficient precautions to avoid the necessity of breach. Goldberg, *An Economic Analysis of the Lost-Volume Retail Seller*, 57 S. CAL. L. REV. 283 (1984), *reprinted in* V. GOLDBERG, READINGS IN THE ECONOMICS OF CONTRACT LAW 109 (1989).

63 Most retail goods are sold at "stated" prices that consumers leave or take as they like. For example, it would be impossible for consumers to go into a McDonald's and bargain over how much a hamburger costs. "Stated price" markets do not necessarily indicate a lack of competition; retailers compete over the stated prices. Indeed, bargaining is inconsistent with a competitive thick market. In thick markets, it would be irrational to bargain over a good's price because goods would never be exchanged for more or less than the spot price.

64 There will be some exceptions. For example, if products are out of season or out of fashion, then rational retailers may prefer to sell them at less than cost. Retail cost will not provide a perfect indication of the retailer's rock bottom price, but cost information may still be relevant to the inquiry. Indeed, the bargaining motive is the likely reason that many automobile consumers investigate the dealership's cost.

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the consumer's reservation price[65] is the threat point *above* which she would prefer not to purchase. Sellers analogously have a threat point *below* which they would prefer not to sell. The Nash Solution posits that bargaining games will lead to exchange at a price which is simply the average of the buyer's and seller's threat points.[66] It may, however, be very difficult for the one party to learn the other's threat point. For example, how would a seller learn what the buyer's reservation price is? The Nash Solution also illustrates why each party will have an incentive to misrepresent her threat point. Buyers will have every incentive to convince the seller that they really don't value a sweater, say, at $100, so that the exchange price will drop in the buyer's favor. When the seller is a retailer who, to survive in the long run, must sell at a price that at least covers its costs, the disclosure of those costs can provide powerful information about the seller's threat point and thus can directly aid consumers in extracting a larger percentage of the gains from trade.

The theoretical value of knowing retailer's cost has been borne out in field experiments. Studies of new car sales have indicated that consumers who appeared to know the seller's cost fared significantly better in the bargaining process.[67] It should be stressed, however, that this "bargaining power" motive for ascertaining dealer cost has primarily a distributional basis. If consumers armed with this cost information are able to buy cars at a lower price, the economy is not necessarily more efficient. The difference between a high and a low price represents to economists simply a transfer of wealth and not an inefficiency.[68] Instead, widespread cost disclosure may make bargaining markets more efficient, by reducing the real costs of bargaining.[69]

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65 *See supra* note 42.

66 The Nash solution is defined more fully in G. OWEN, GAME THEORY 129-40 (1982).

67 *See* Cioldini, Bickman & Cacioppo, *An Example of Consumeristic Social Pyschology: Bargaining Tough in the New Car Showroom*, 9 J. APPLIED SOC. PSYCHOLOGY 115 (1979); Jung, *supra* note 45; Taylor & Dawid, *Bargaining for a New Car: The Knowledgeable Versus the Naive Consumer*, 59 PSYCHOLOGY REP. 284 (1986).

68 In the antitrust context, the higher price that consumers pay monopolists does not represent any inefficiency in an economic sense. The inefficiency stems from those people that stop buying at the higher price. R. POSNER & F. EASTERBROOK, ANTITRUST CASES, ECONOMIC NOTES AND OTHER MATERIALS 4-11 (1981).

69 Markup disclosure may not only shorten the length of the bargaining process, but may also reduce the number of lost opportunities that stem from the incentives to bluff in bilateral bargaining situations. The incentives of buyers and sellers to misrepresent their reservation prices and threat points may cause the parties to forgo value creating exchange. In the earlier example, even if a buyer values the sweater at $100 and the seller at $50, each may try to bluff the other party into thinking otherwise. The buyer may try to bluff that she values the sweater at $60 and the seller may represent that the sweater is really worth $70 to him. If this dual bluffing continues, the parties may fail to contract.

Consumer knowledge of the retailer's markup undermines the retailer's ability to bluff because the consumer has independent information about the retailer's reservation price. Thus, in the sweater example, even if the buyer continues to bluff that the sweater is only worth $60, she is likely to forgo a beneficial trade if she knows the seller's reservation price. Disclosing the markup gives at

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If all consumers were given information about seller's cost, there would probably be a smaller dispersion of retail sale prices in bargaining markets. Uniformly knowledgeable buyers would bargain to more uniform prices than buyers with different degrees of information about the seller's markup. The primary distributional consequence of markup disclosure would thus be a more uniform sales price. This in itself might be valued by society as a more equitable result. It is harder to predict, however, whether markup disclosure would lower the *average* price that consumers pay—and thus redistribute wealth toward consumers. Several studies have documented significant price dispersion across consumers buying similar new cars.[70] The very fact of persistent price dispersion in retail car sales is inconsistent with perfect competition. Since no dealer would want to sell below cost, the fact of a range of sales prices indicates that the average price must be above the dealer's marginal cost.[71] Thus, there is room for competitive improvement—if cost disclosure increases competition. Markup disclosure might well enhance market competition by increasing the efficiency of consumer search. The decreased price dispersion might be accompanied by a lower average price—as the uninformed consumers that were paying high markups would bargain for a lower price. A society that favored consumer protection might, on distributional grounds, independently promote cost disclosure.

In sum, consumers may rationally value markup disclosure in thin markets. A knowledge of the retail markup may make the search and bargaining process more efficient. Cost information may also powerfully affect the bargaining power of the parties. As a result, markup disclosure would be valued by consumers for both efficiency and distributional reasons. With the consumer value of markup disclosure in thin markets now established both empirically and theoretically, the question arises as to why the market is failing to respond effectively to consumer demand for this information.

III. WHY THE MARKET FAILS TO PROVIDE SELLER COST INFORMATION.

If consumers value cost information, our first intuitions are that competition would encourage retailers to provide it. The simple compet-

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least one party to the contract better information about the gains from trade (the difference between the threat points), thus putting that party in a better position to judge whether the exchange can be mutually beneficial.

70 *See* Ayres, *supra* note 39; *see also* Jung, *supra* note 48.

71 Competition may drive the average price to the dealer's average cost if the dealership incurs certain fixed costs that must be amortized across different sales. If there are significant fixed costs in retail services, then the high-price buyers may cross-subsidize the low-price buyers' share of these fixed costs. *See* Bittlingmayer, *Decreasing Average Cost and Competition: A New Look at the Addyston Pipe Case*, 253 J.L. & ECON. 201 (1982); Wiley, *Antitrust and Core Theory*, 54 U. CHI. L. REV. 556 (1987).

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itive story would be that any competitor that started to reveal its markup could give itself a competitive advantage over its rivals. Other things being equal, consumers would prefer shopping at stores that revealed their cost, so that retailers who refused to reveal their markup would be driven from a competitive market.

The reality of the marketplace, however, is strikingly at odds with this simple competitive story. There are very few instances in which retailers reveal their costs or markups. In the retail market for new automobiles, for example, consumers are forced to go to the third-party estimates of *Consumer Reports* or *Edmunds*. But such third-party cost services cannot completely correct the market failure. First, it must be much cheaper for retailers to provide this information. Retailers necessarily and costlessly know the price at which they purchase goods. Third-party services must expend real resources in investigating and imperfectly trying to verify their cost estimates. Second, consumers cannot fully rely on the cost estimates of third-party services. *Edmunds*, for example, disclaims on the first page of each of its publications that "[a]ll information and prices published herein are gathered from sources which, in the editor's opinion, are considered reliable, but under no circumstances is the reader to assume that this information is official or final."[72] The quality of this markup information is significantly reduced by the fact that the third-party estimates do not include the hidden rebates (sometimes called "holdbacks") which manufacturers "kick back" to dealers periodically for completed sales.[73] Because third-party services, like *Edmunds* or *Consumer Reports*, are more costly and less reliable then direct markup disclosure from dealers, the existence of third-party services can at best only mitigate the market failure to provide information which consumers value.

In this Section, we suggest three reasons why retailer competition might not lead to the disclosure of cost information: credibility disincentives, first-mover disincentives, and bargaining disincentives. In some markets, these disincentives may work in combination to preclude markup disclosure.

A. Credibility Disincentives

Retailer competition will discourage revelation of markup information if the costs of privately producing and then communicating the information is greater than the consumer value. The costs of privately

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72 *See, e.g.*, EDMUNDS 1989 NEW CAR PRICES (1989).

73 *Edmunds* warns the reader that "[a] 'dealer holdback' and/or 'finance charge' is included in the [base cost] of all domestically produced vehicles." *Id.* Remar Sutton describes the "holdback" as "the two or three percent of the profit [that the manufacturer] 'holds back' from the dealer. The dealer conveniently considers this a *cost*, since he actually pays the manufacturer this money. However, every three months or so, the [manufacturer] sends the dealer a check for all those two and three percents." R. SUTTON, DON'T GET TAKEN EVERY TIME 79 (1986).

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producing the information are minimal. It is difficult to imagine that retailers would sell a product without knowing what they paid for it. Not having the information suggests an act of deliberate amnesia, since the retailer must have been aware of its own costs at the time of purchase.[74] The costs of credibly communicating this information to prospective customers, however, can be sizable. The consumer must have some reason for believing that the information is true for it to be credible. In many instances, retailers can establish a reputation for honest dealing that increases the credibility of representations about the quality of their cars or the service they will provide. A reputation for honest cost disclosure, however, is difficult for consumers to verify.

The legal system can play an important role in determining the cost of credible communication. In the current legal system, fraudulent misrepresentations of cost are a common, if not accepted, advertising practice. Car retailers will routinely represent that they are willing to sell their cars for $1 above their invoice cost, without revealing that the dealerships receive significant rebates from the car manufacturers so that the invoice cost does not reflect true dealer cost. Such misrepresentations are not limited to the car retail market. Examining the label of America's largest selling beer, Budweiser, one finds what must be a clear cost misrepresentation: "We know of no brand produced by any other brewer which costs so much to brew and age." Because Budweiser is not a premium-priced beer, the representation about higher cost, which has been unchanged on the Budweiser label for years, is tantamount to representation of a low—if not the lowest—markup. Few consumers who give the issue any thought would seriously believe that Budweiser beer costs the most "to brew and age."[75]

In Section I we argued that state and federal laws are beginning to recognize that cost misrepresentations can be deceptive practices and give rise to an action in fraud, but the reality is that consumer protection agencies, such as the FTC, seldom prosecute such cases and common-law courts continue to resist finding for buyers who have relied on misrepre-

[74] Anthony Kronman has distinguished between deliberately acquired and casually acquired information. Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 30-32 (1978).

[75] Budweiser might defend itself by noting that it represents only that it "knows of no brand produced" that costs more. It defies the imagination, however, that Budweiser could be so ill-informed about its rivals. Alternatively, the Company might argue that when it speaks of the costs "to brew and age," it is referring to the total costs of brewing all their beer and not the marginal cost per can. Such an interpretation, however, would pass muster under current deceptive advertising laws only if consumers understand the claim in these terms. If instead they interpret the claim to mean that Budweiser makes less of a profit on each can of beer than other manufacturers do, and that claim is false, then another manufacturer of beer could successfully charge Budweiser with deceptive advertising under § 43a of the Lanham Act, 15 U.S.C. § 1125(a) (1982). Budweiser's claim may also run afoul of the Federal Trade Commission Act's prohibition of "unfair or deceptive acts or practices. . ." 15 USC § 45(a)(1) (1989); *see also* 15 U.S.C. § 55(a)(1) (1989) (defining false advertisements in connection with food or drug products).

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sented prices.[76] Under these current conditions, nonfraudulent retailers face significant costs in disclosing their true markups. Because consumers are accustomed to the fraudulently low misrepresentations of dishonest competitors, truthful disclosure can actually reduce demand.

Moreover, even in a world without cost misrepresentation, the costs of effectively communicating can be significant if different retailers use different methods of disclosing their costs. If some retailers include overhead expenses, while others deduct manufacturer rebates, consumers will be forced to compare disparate forms of markup information that will reduce the effectiveness of any single disclosure. Consumers might then value disclosure less for the simple reason that it will be harder to compare with other dealers, and to develop benchmarks for comparison.

B. First-Mover Disincentives

Even in a world where the costs of credibly and effectively communicating markup information were negligible, profit-maximizing retailers might still refuse to reveal their markups. Contrary to the basic traditional economic argument, disclosing retail markups might actually reduce a retailer's demand. Under this scenario, there would be no competitive incentive to be the first retailer to reveal markup information, even if consumers valued this information.

One reason for this first-mover disincentive might be consumer misinterpretations. If consumers currently underestimate the competitive retail markup, it is possible that being the first retailer on the block to reveal the true markup could actually reduce sales. For example, if consumers think that a reasonably competitive retail markup should be ten percent, and the real markups actually range between twenty and thirty percent,[77] then even the lowest markup firm might lose business by coming forward. The first retailer to "break the bad news" to the consumer could actually induce more consumers to search *away* from its store than if it remained silent. In the above example, consumers shocked by the twenty percent markup might actually be more inclined to shop elsewhere than if they had maintained their blissful ignorance.

In such situations, competitive pressure, if anything, will reinforce retailers' decisions not to reveal their markups. The potential for consumer misperceptions is exacerbated by the prevailing retailer practice

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[76] For a discussion of possible agency and judicial resistance to the proposals of this Article, see *infra* note 95 and accompanying text.

[77] The actual size of retail markup varies across the more specific markets for consumer goods. A sampling of research in these markets revealed the following examples of retail markups: Auto Parts (specifically catalytic converters)—300%, Stammer, *EPA Cites 23 Muffler Shops in California*, L.A. Times, Feb. 22, 1989, at 3, col. 5; Pharmaceuticals—35-40%, Shaffer, *Upjohn Expects to Sell $100 Million worth of Rogaine in 1988*, REUTER BUS. REP., Oct. 13, 1988; Sporting Goods—40%, FORTUNE, Feb. 22, 1982, at 84 (according to National Sporting Goods Association); Furniture—50-60%, BUSINESS WEEK, Sept. 18, 1978; Levi's Blue Jeans—40-50%, BUSINESS WEEK, Nov. 10, 1975.

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and judicial acceptance of cost misrepresentation. Because cost disclosures are frequently overstated, a retailer may paradoxically be put at a competitive disadvantage by being the first to truthfully reveal what the consumers wish to know.

C. *Bargaining Disincentives*

Retailers may also fail to reveal markup information if it puts them at a bargaining disadvantage. As discussed above,[78] possessing information about markups may increase a consumer's bargaining power. An important reason that automobile buyers want markup information is to reap the inherent advantage that information provides; not surprisingly, automobile retailers may resist revealing it for similar strategic reasons.[79] Sellers may prefer to keep consumers in the dark so that they can themselves bargain more effectively.[80]

One would think, however, that competitive pressures should overcome this disincentive. Although the sellers collectively would prefer to withhold markup information, individual sellers should be tempted to reveal markups in order to increase their individual sales volume. We suggest that this competitive result may not come to pass for both collusive and noncollusive reasons.

Most directly, if retailers are collectively better off by not revealing markup information to consumers, they may collusively agree not to reveal. The ability of retailers to collude will turn on several structural variables in a particular market affecting the retailers' ability to reach agreement on withholding markups, detect breaches of the agreement, and effectively punish firms that breach the collusive agreement.[81] In the retail automobile market, for example, while the number of retailers in many metropolitan markets seems too large to support a collusive agreement, the smaller number of car manufacturers might help organize and support markup nondisclosure collusion. The manufacturers will potentially gain from any strategy that increases the ability of the retailers to price discriminate more effectively and thereby extract a larger portion of consumer surplus, which can then be passed upstream via a higher wholesale price.

Even where such collusion is not sustainable, there may be in-

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[78] *See supra* notes 37-38 and accompanying text.

[79] Professors Haddock, Macey and McChesney, in the corporate takeover context, have argued that seller resistance may be efficiency enhancing. *See* Haddock, Macey & McChesney, *Property Rights in Assets and Resistance to Tender Offers*, 73 VA. L. REV. 701 (1987). Refusals to reveal *markup information* are unlikely to enhance efficiency because, unlike the takeover context, such refusals do not protect sellers' incentives to undertake value-enhancing investments.

[80] From the seller's perspective, more effective bargaining is tantamount to more effective price discrimination—as the retailer attempts to sell to each consumer at a price just below the consumer's reservation price.

[81] *See* Ayres, *How Cartels Punish: A Structural Theory of Self-Enforcing Collusion*, 87 COLUM. L. REV. 295 (1987).

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dependent, noncollusive reasons that keep individual retailers from revealing markup information in bargaining markets. In bargaining markets, consumers buy similar products at different prices—the bargaining process thus fosters a type of price discrimination which causes some consumers to pay more for the same car.[82] Independent retailers may choose not to reveal markup information if they earn more from this price discrimination with nondisclosure than they would from the higher volume (but lower markups) if they disclosed.

Again returning to our paradigmatic automobile example, consider the phenomenon of sticker sales. The sticker price of automobiles on many new cars is more than $3,000 above the dealer's cost. Most automobile consumers pay substantially less than sticker,[83] but a significant percentage of sales are made at or near the sticker price.[84] These "sucker" sales may occur because consumers don't know it's a bargaining market or dislike bargaining for a lower price.[85] While researchers often focus on price dispersion, it may be that the more important economic variable is the concentration of profits which price dispersion generates. If ten percent of the dealer's sales represent fifty percent of the dealer's profits, then dealers will rationally go to great lengths to seek out suckers. If these sucker sales represent a significant portion of each dealership's profits, the dealers may rationally and noncollusively decide to withhold markup information. Markup disclosure would probably increase the volume of cars sold, but it might drastically reduce the number of sucker sales. It would be much harder in a markup disclosure world to convince a consumer to buy at a few hundred dollars off sticker price if the consumer knows that this price still entails a $2,000 profit markup. Rational dealers may prefer to keep their lower-volume, high-profit sucker sales rather than move to the more competitive high-volume equilibrium that markup disclosure entails.

Thus, even though markup disclosure may reduce the consumer's real costs of search and bargaining, retailers may strategically refuse disclosure. This refusal can be seen as a type of "rent-seeking" in which the

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82 The persistence of price discrimination in a market is itself an indication that what economists call "perfect competition" is not present. Borenstein, *Price Discrimination in Free-Entry Markets*, 16 RAND J. ECON. 380 (1985). In perfectly competitive markets, all goods will sell at a single price (equaling the seller's marginal cost). Nondiscriminatory sellers would drive out discriminatory sellers by making nondiscriminatory and lower offers to the discriminated class.

83 *Consumer Reports* suggests that a $300 profit is reasonably competitive. However, there are no published reports on the actual distribution or average markup. *How to Get the Best Deal*, CONSUMER REP., Apr. 1986, at 211. Manufacturers undertake this research, but guard their data carefully. Telephone interview with G.M. marketing analyst, Marketing Division of General Motors Corp. (July 1988).

84 R. SUTTON, *supra* note 73, at 37.

85 Some salesmen use the sexist term of "lay-downs" to refer to women who are willing to pay the sticker or near-sticker price. Some classes of consumers may be forced to pay a near-sticker price because salespeople systematically refuse to offer them lower prices. *See* Brown, *Sexism in the Showroom?*, Wash. Post, Feb. 12, 1989, at H1, col. 1; Ayres, *supra* note 39.

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retailers are willing to inefficiently reduce the total gains from trade to get a larger piece of the pie.[86]

In sum, there are three primary ways in which disclosure disincentives may work against the release of cost information in a given market. First, credibility disincentives can preclude disclosure by raising the cost of effectively communicating the information. Second, consumer misperceptions can undermine the incentives of any firm being the first to reveal this information. Third, the profitability of sucker sales in a bargaining market can discourage noncollusive as well as collusive retailers from revealing the size of their profits.

While these disclosure disincentives have been discussed separately, they may work in tandem. As dramatically illustrated by the market for new automobiles, retailers have reasonably come to the conclusion that—even though consumers value the information—it is simply not profitable to systematically reveal their true markups. Our broader thesis that promoting markup disclosure can increase equity and efficiency does not, however, necessarily turn on the persuasiveness of our disincentive analysis. Even if the reader does not accept our theories of market failure, the fact of market failure still inheres in our theoretical and empirical arguments that some consumers want markup information, but market competition fails to provide it.

Understanding the specific causes of market failure is, however, important. The appropriate legal response to promote markup disclosure should flow from a particular theory of market failure. Diagnosing the correct cause of market failure can thus lead to the correct legal cure. The next Section accordingly examines a range of legal interventions that are tied to the reasons that firms fail to disclose their markups.

IV. LEGAL ALTERNATIVES FOR PROMOTING RETAIL MARKUP DISCLOSURE

In the face of this market failure, what is to be done? This Section investigates a range of legal responses that promote markup disclosure and therefore may improve the efficiency and equity of the market. Even admitting market inefficiency, however, does not necessarily imply that government intervention is cost-justified. Experience has shown that many forms of government intervention can impose costs that are greater than those of the unregulated market.[87] Thus, even in the face of market

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[86] *See* Ayres & Gertner, *supra* note 51 (discussing how contractual parties may refuse to disclose value enhancing information for analogous rent-seeking reasons).

[87] Regulated agencies, for example, can be "captured" by the very firms they are mandated to regulate. Captured agencies have been the source of many inefficient regulations. For a more detailed description of administrative capture theory, see Peltzman, *The Growth of Government*, 23 J.L. & ECON. 209 (1980); Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971); Wiley, *supra* note 71.

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failure, we may still conclude that in the majority of markets, the legal response should be to do nothing.

We propose that in a limited set of retail markets and with limited forms of government intervention, the law can properly promote markup disclosure. Our purpose here is to identify some of these specific markets and the specific forms of appropriate intervention. Our central thesis is that the form of government intervention in a given market should be a by-product of the specific causes of market failure. The reason that retailers fail to disclose their markups should dictate our policy response.

For example, when the unregulated market "artificially" increases the costs of credible communication, legal intervention can promote markup disclosure by simply making it cheaper to talk. Legal rules can reduce the costs of credible communication in two distinct ways. First, we discuss how prohibiting misrepresentation of retail costs can help retailers credibly commit themselves to honesty. Second, we investigate how setting standards for markup revelation may lower the costs of effective communication by providing consumers with a uniform benchmark for comparison. Both of these legal responses do not mandate disclosure but merely regulate the manner of any disclosure for which retailers may opt. These legal rules create a more efficacious production function; the good produced here is the information about the seller's costs. Prohibiting misrepresentation and setting disclosure standards are both examples of laws that reduce a particular type of transaction cost—the cost of communicating the markup.[88]

As seen in the last Section, the failure of retail competition to engender markup disclosure may not solely be attributable to the costs of credible communication. We argued that sellers in some markets would refuse to reveal their costs even if it were costless to communicate. In these limited markets we investigate a more intrusive form of government intervention: mandatory disclosure.

As we have stressed, many regulations are not worth the cost. Policymakers should be especially sensitive to the market response to government intervention. Retailers may attempt to resist the regulation by nullifying cost disclosure, they may attempt to exploit the regulation to facilitate collusion, or markup competition may distort retailer and consumer behavior in ways that significantly reduce the appropriateness of such legal intervention.

A. The Least Intrusive Intervention: Making Markup Misrepresentation Actionable

Market competition will only cause information to be revealed when the costs of communication are less than the consumer's value for the

[88] Reducing informational costs of transactions will facilitate trade. *See* Gilson, *Value Creation by Business Lawyers: Legal Skills and Asset Pricing*, 94 YALE L.J. 239 (1984).

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information. The market can fail to provide information that consumers want if the cost of this information good is greater than its value.

If the marketplace of ideas is completely unregulated, it can become quite expensive to speak credibly simply because rational listeners will discount the speaker's veracity. Allowing speakers to lie with impunity engenders a linguistic form of Gresham's law[89] in which dishonest speech drives out the honest speech by making it more costly.[90] One speaker's dishonesty imposes an externality on all other speakers, making it harder for all other speakers to be heard.[91]

Making fraudulent misrepresentation actionable promotes value-creating trade.[92] Being susceptible to civil liability for misrepresentation allows speakers to more credibly commit themselves to honesty. The contingent nature of this liability for lying can drastically reduce the cost of communicating in a way that consumers will believe. In effect, every communication carries with it a postscript: "Cross my heart and hope to pay civil damages if I'm lying."

While federal regulations and some common law precedents make cost misrepresentations de jure illegal, the de facto enforcement practices of the FTC and its state counterparts leave consumers largely unprotected. The simplest and least intrusive government intervention would be:

(1) to explicitly overrule the common law of the precedents suggesting that misrepresenting seller's costs is immaterial to rational consumer choice;
(2) to promulgate FTC regulations making it even more explicit that misrepresentations of retailer's cost or markups would be an actionable deceptive trade practice under the Federal Trade Act;[93] and finally,

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89 Sir Thomas Gresham hypothesized that "bad money drives out good." R. LIPSEY, P. STEINER & D. PURVIS, ECONOMICS 624 (1984).

90 Opportunism drives out trade—and fraud is an extreme form of opportunism. Courts occasionally refuse to enforce fraudulent contracts or allow damages therein in the effort to undermine the use of contracts deemed against public policy. *See, e.g.*, McConnell v. Commonwealth Pictures Corp., 7 N.Y.2d 465, 166 N.E.2d 494, 199 N.Y.S.2d 483 (1960) (allowing defendant to rescind opportunistically illegal contract); Karpinski v. Collins, 252 Cal. App. 2d 711, 60 Cal. Rptr. 846 (1967) (allowing plaintiff to recover opportunistic secret milk kickback).

91 *See, e.g.*, Lefkowitz v. Great Minneapolis Surplus Store Inc., 251 Minn. 188, 86 N.W.2d 689 (1957). In this case, the Minnesota Supreme Court refused to enforce a retailer's offer of fur coats "worth up to $100" for "$1 each," thus making it more difficult for other retailers to persuade consumers to rely on their offers as their confidence in such representations was eroded. To the extent that consumers cannot distinguish between bona fide offers from fraudulent offers to sell "$100 dollar fur coats for $1" or to sell cars "for $1 over dealer invoice" then consumers will tend to disbelieve all offers. It will be harder for honest sellers to compete on the basis of how big their markup is.

92 The process of trade or exchange creates value by allocating goods to higher-value owners. If I own a sweater which I value at $30 but which you value at $40, then any contract price by which I sell you the sweater creates $10 of value.

93 Alternatively, the FTC could simply begin to enforce the existing regulations prohibiting deceptive trade practices, as argued *supra* notes 19-22 and accompanying text. Such regulations, however, are ambiguous and past practice has failed to notify sellers that misrepresenting markups is

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(3) to promote both public and private enforcement of these fraud or deceptive trade standards.[94]

Strengthening the legal response to fraudulent misrepresentations of seller's cost would promote markup disclosure by lowering the cost of credible communication.[95]

B. Promulgating a Disclosure Standard

Implicit in making markup misrepresentation actionable is the idea that courts will need to distinguish between what is truthful and what is not. The judiciary will be forced into the business of setting legal standards for what constitutes truthful disclosure. In some situations, however, the law can properly take a more active role in establishing the form and manner of markup disclosure. Courts deciding whether a particular representation is fraudulent will focus primarily on the truthfulness of the representation. The law can importantly affect the cost of disclosure by regulating its veracity and form so that it is more readily understood by consumers and more useful to consumers in comparing alternative markups.

Promulgating regulatory standards for how markups are to be calculated and disclosed would make markup disclosure more meaningful. Requiring uniformity in the calculation and disclosure of markups might make it easier for consumers to understand or compare different retailers. Without such regulated uniformity, retailers might remain truthful but obfuscate the form of their disclosure to make it meaningless.[96] Consumers would be forced to evaluate disparate markup measures, making it harder for them to determine what the competitive markup should be.

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potentially actionable. Accordingly, it is more appropriate for separate rulemaking to clearly articulate the boundaries of a violation.

94 An especially effective way to empower consumer groups would be to give such groups legal standing to use testers to audit and enforce substantive disclosure standards. Such standing, for example, is available in fair housing cases to testers seeking to uncover discriminatory trade practices. *See, e.g.*, Havens Realty Corp. v. Coleman, 455 U.S. 363 (1982).

95 Of course, it is possible that the same structural forces that have kept regulatory agencies and the courts from prohibiting markup misrepresentation could keep them from enacting or enforcing even this least intrusive policy alternative. A crude public choice theory might, for example, predict that concentrated sellers (such as automobile dealers) are more likely to capture regulatory decisions than diffuse consumer interest groups. There are two answers to such arguments. First, the proposals in this Article are directed toward what the law should be, not what necessarily is implementable by the body politic. Second, by demonstrating that markup disclosure could improve the equity and efficiency of certain markets, this Article may mobilize public interest groups and publicly minded regulators to re-examine past practices. Common law judges, for example, might change their view that it is unreasonable to rely on seller representations even in "thin" markets.

96 Obfuscation is a time-honored tactic. Unregulated insurance contracts, for example, were often "printed in such small type, and in lines so long and so crowded, that the perusal of [them] was made physically difficult, painful, and injurious. Seldom has the art of typography been so successfully diverted from diffusion of knowledge to the suppression of it." Delancey v. Insurance Co., 52 N.H. 581, 588 (1873).

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For many retail items, the simplest and most useful cost standard to use would be the transfer price paid to the manufacturer—that is, the marginal cost at the retail level. Calculating marginal cost at the manufacturer's level is often a difficult and imprecise process; in antitrust predatory pricing cases, courts and academics have long struggled to find a workable standard for estimating this species of marginal cost.[97] At the retail level, however, it is much easier to calculate marginal cost. In many retail contexts, the marginal cost of a product simply consists of a direct payment to the manufacturer.[98] It may be difficult, in other words, to calculate the manufacturer's marginal cost of producing a frozen pie, but it is relatively straightforward for a retail grocer to reveal how much it paid the manufacturer for a pie.[99] In some retail markets, this type of marginal cost accounting would be more difficult and, as discussed later,[100] high-markup retailers might be expected to intentionally restructure their production to circumvent or undermine the disclosure standards. But, even taking into account this market resistance, uniform standards for revealing cost or markup information can dramatically spur competition in this new dimension of product "quality." Manufacturers able to speak credibly about their costs may begin to compete for consumers on the basis of markup size.

The pro-competitive effect of setting uniform standards is seen in other areas of consumer protection. Recently, the federal government began to collect information about airline time performance on individual routes. Before this government action, it was exceedingly difficult for punctual airlines to communicate information about their superior service to the public. Carriers could cite different statistics about their on-time record, but it would be difficult for consumers to compare these disparate representations. The uniform reporting standard, however, has spurred a great deal of advertising about on-time performance. The carriers that are more punctual than their competitors are explicitly capitalizing on government standards in their advertising.[101]

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97 *See* Utah Pie Co. v. Continental Baking Co., 386 U.S. 685 (1967); Moore v. Mead's Fine Bread Co., 348 U.S. 115 (1954); United States v. National Dairy Prod. Corp., 322 U.S. 29, 34-35 (1963); Pacific Eng'g & Prod. Co. v. Kerr-McGee Corp., 551 F.2d 790 (10th Cir. 1977); E.B. Mullen v. FTC, 142 F.2d 511, 517 (6th Cir. 1984); McGee, *Predatory Price Cutting: The Standard Oil (N.J.) Case*, 1 J.L. & ECON. 137 (1958); Posner, *Exclusionary Practices and the Antitrust Laws*, 41 U. CHI. L. REV. 506, 515-23 (1974); Yamey, *Predatory Price Cutting: Notes and Comments*, 15 J.L. & ECON. 129 (1972).

98 Other costs of retail "production" such as advertising, rent, and other overhead expenses are largely fixed and consequently do not affect the marginal cost of sales. Although some retail costs (such as a salesperson's time in selling a car) are properly included in a complete measure of marginal cost to avoid retailer manipulation, a simple standard of revealing the amount paid to the manufacturer is the easiest to calculate and least subject to abuse.

99 *See Utah Pie Co.*, 386 U.S. 685.

100 *See infra* note 113 and accompanying text.

101 For example, refer to American Airlines' $25 million advertising campaign pushing its "On Time Machine" advertising slogan in 1988. American is clearly taking advantage of the Department

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This standardization effect is also demonstrated in the area of government labeling and grading of fruits, vegetables, and other consumer grocery items.[102] The simple grading of produce and other grocery items triggered a new form of retail competition. It increased the efficiency of consumer search for these goods by transforming experience goods (consumers could not see inside a can of tomatoes) into search goods by revealing to consumers the quality of the product before they buy it.[103] Government grading created an objective standard of quality that increased the efficacy of consumer search.

In a wide range of retail markets, regulatory structures already exist that could be used to enforce cost disclosure standards.[104] The FTC Consumer Protection Division, which already supervises the regulatory requirement of uniform quality disclosure, could begin to oversee an industry's compliance with cost disclosure standards. An excellent example appears once again in the automobile industry. In this industry, consumer protection legislation already exists, on both a state and federal level, that requires dealers to list items such as the manufacturer sticker price and transportation costs.[105] The additional costs of enforcing uniform markup disclosure would be marginal.

Markup standards would not force retailers to talk. They would regulate the manner of disclosure only if retailers chose to talk. Retailers would opt for disclosure only if it was to their advantage to comply with the standards and disclose their markup. If for some reason the standards make effective disclosure more costly, little is lost because few retailers currently disclose their cost. There would be minimal chilling effect of regulation because there is currently so much silence. Thus, while promulgating standards for the form of cost and markup disclosure is more intrusive than merely outlawing dishonest disclosure, it is unlikely to reduce the amount of disclosure. On the other hand, if promulgating disclosure standards lowers the cost of effectively communicating, then the standards by themselves may engender more markup disclosure and the attending benefits of equity and efficiency.

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of Transportation's new time performance statistics to gain a nonprice competitive advantage in the industry. *See* ADVERTISING AGE, Nov. 9, 1988, at 24.

102 For government standards on foods in general, see 21 U.S.C. §§ 341, 343 (1989); 21 C.F.R. §§ 101, 130-169 (1989).

103 *See* Burck, *Plain Labels Challenge the Supermarket Establishment*, FORTUNE, Mar. 26, 1979, at 70.

104 *See, e.g.*, The Automobile Information Disclosure Act, 15 U.S.C. §§ 1231-1233 (1988); The Fair Packaging and Labeling Act, 15 U.S.C. §§ 1451 *et seq.* (1988); certain weights and measures acts such as those pertaining to the labeling of foods in 21 U.S.C. §§ 341, 343 (1988).

105 15 U.S.C. §§ 1231-1238 (1989). It might also be desirable to regulate the method of optional disclosure. For example, if a dealer chooses to reveal its markup, federal or state regulation might require that it be included as a term of the sales contract or as an item on the sales sticker. Regulating the method of disclosure is similar to the used-car "lemons" regulations, which mandated that dealers specify whether the car was sold with a warranty or "as is." In this context, regulation might require the dealer to state whether the car was sold with markup disclosure or not.

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C. *The Possibility of Targeted Mandatory Disclosure*

The economic case for mandatory disclosure of retailers' costs or markups is harder to make. As we have argued, using the law to reduce the cost of communication should be sufficient to induce retailers to provide markup information when consumers value it. Once a regulatory standard is established for truthfully disclosing markups, individual retailers should, in many instances, be tempted to reveal their cost in order to gain a competitive advantage. Again, the argument is that consumers, *ceteris paribus*, would prefer to buy from a retailer who certified a maximum markup level on all items in the store. Others retailers would then be forced to follow suit. The end result would be an equilibrium of voluntary cost disclosure throughout the market.

Indeed, one could argue that going beyond voluntary disclosure might reduce social welfare. Requiring cost disclosure when the costs of communicating are higher than the value of the information to consumers would force retailers to provide a service whose value is less than its cost. It is hard to imagine, however, that the costs of markup disclosure are high. Retailers inherently know the price at which they bought.[106] Even if mandatory markup disclosure was established in a thick market—the kind of market in which consumers do not value markup information—the direct social loss would be minimal.[107]

In Section III, we discussed two reasons why retailers might not voluntarily reveal information even when there was a cost incentive to communicate. Consumer misperception about the size of competitive markups might actually put a retailer at a competitive disadvantage by revealing the markups. In such cases, retailers might collectively want to reveal their markups, but no individual retailer wants to be the first to disclose.[108] And, as argued earlier, retailers in a bargaining market may refuse to efficiently reveal their markup to maintain a better bargaining position.

Under such circumstances, retailers will not reveal cost even if fraud actions and disclosure standards make the costs of credible and effective

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106 The cost of mandatory markup disclosure would therefore be similar to the negligible costs for lenders in disclosing the interest rate under the Truth in Lending Act, 15 U.S.C. §§ 1601-1604 (1982). *See* Donohue & Ayres, *Posner's Symphony No. 3: Thinking About the Unthinkable*, 39 STAN. L. REV. 791, 802 (1987) ("These costs [of disclosure] are minimal: Few institutions lend without knowing the annual interest rate, so the marginal cost of disclosure amounts to about the cost of the ink used in printing a 2-digit number.").

107 *But see infra* note 112 and accompanying text for a discussion of indirect losses that might be occasioned by legal intervention.

108 The retailers collectively might be better off if markups were disclosed because consumers would ultimately have more confidence in the markup (and would have to undertake less inefficient search). Industry sales might even increase. The inability of competitors to co-ordinate socially beneficial innovation is found in other areas of economics. *See* Farrell & Saloner, *Standardization, Compatibility and Innovation*, 16 RAND J. ECON. 70 (1985) (when innovation creates social benefits which are external to individual firms, competition may not produce innovation).

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communication negligible. Mandatory cost disclosure may thus be the only way to produce socially valuable information. Again, however, the form of government intervention should be tied to the type of market failure.[109] Mandatory markup disclosure should be used only when the market is failing for reasons unrelated to the costs of communication. In these cases retailers will not voluntarily move towards a cost disclosure equilibrium. The specific causes of market failure detailed in Section III may be misspecified or incomplete. The larger question for efficiency-minded lawmakers, however, is to ask what retailers would do in a world of costless disclosure. If they would still refuse to disclose socially valuable information, then mandatory disclosure is warranted.

The new car market serves as a paradigmatic example. Even with a clear disclosure standard, it is unlikely that retailers would volunteer to reveal their markups in the bargaining process. Consumers value this information and inefficiently pay third parties for estimates of information that the retailers readily have available. In such situations, the law may need to give the market equilibrium a nudge. Armed with markup information, consumers would bargain for more uniform and arguably lower prices. Moreover, the process of searching and bargaining for a car would become much less time-consuming and costly. Mandatory disclosure requirements might accordingly improve both the equity and efficiency of such targeted markets. Markup disclosure for new cars could easily be included on the federally mandated price sticker.[110]

The proper ambit of this mandatory intervention would be quite limited. Many markets are sufficiently thick so that consumers do not value information about seller's cost. Moreover, when seller's cost is valued, encouraging voluntary disclosure with uniform standards will often be sufficient. For this reason, the prudent course of action in even the automobile market might be to stiffen penalties for fraudulent disclosure and to promulgate clearer disclosure standards. Mandatory disclosure could then be used as an intervention of last resort, when the market continues to fail to provide information that consumers patently desire.[111]

In tailoring specific legal responses, policymakers should be attuned to the costs of implementing either mandatory or voluntary markup reg-

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109 *See* Ayres & Gertner, *supra* note 51 (theories of contractual incompleteness should inform how efficiency-minded courts set contractual defaults).

110 Markup disclosure might also relate to other aspects of buying a new car—including extended warranties and financing. Although consumers often do not bargain for these nontangibles, they represent pure retail products that dealers buy at ascertainable prices and mark up in selling to consumers.

111 As emphasized above, *supra* notes 72-73 and accompanying text, the existence of third-party services (like *Consumer Reports* and *Edmunds*) may mitigate but cannot eliminate the inefficiencies stemming from retailers' failure to disclose. In some circumstances, however, the mitigating effect of third-party markup services might make them a better alternative than mandatory disclosure, given its costs of administration and socially inefficient resistance.

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ulations. We now examine how the market is likely to respond to legal interventions in ways that may seriously mitigate their usefulness.

D. Market Resistance

In implementing any of the foregoing legal attempts to encourage markup revelation, policymakers should evaluate how market participants are likely to respond to specific forms of government intervention. In particular, regulators should be aware of how retailers may try to strategically manipulate disclosure standards to their benefit.[112] This Section examines a number of different types of retailer resistance to markup regulation. In some instances, the cost of resistance will negate the benefits of regulations. Being aware of the forms of resistance, however, can encourage policymakers to structure regulations which minimize the opportunities for such strategic manipulation.

1. *Vertical Integration.*—One way that industries may attempt to undermine cost disclosure standards is by vertical integration—merging manufacturing and retail production into single corporations. In industries where retailers are wholly-owned subsidiaries of the manufacturing company, it is much harder to estimate marginal cost. Vertically integrated firms may manipulate the price at which they transfer goods from the manufacturing unit to the retailing unit. By artificially increasing this transfer price, the retailer could claim a low markup and thereby gain a competitive advantage. Indeed, encouraging markup disclosure might for this reason induce retailers to merge with manufacturers.

Requiring markup disclosure might nevertheless be appropriate. In situations where a manufacturer is partially integrated—where, for example, a manufacturer sells some of its product through wholly-owned retailers and some through independently-owned retailers—it might still be possible to force the wholly-owned retailers to represent an accurate wholesale price. Integrated sellers could be forced to disclose the wholesale cost to their unintegrated retailers. This would, in all but the most completely integrated markets, ensure the reliability of the disclosed cost information and maintain its usefulness.

The difficulties of estimating marginal cost for integrated firms are

112 Some standards for cost accounting can easily be adopted from generally accepted accounting principles to aid in cost disclosure. For example, in times of inflation, retailers will have an incentive to adopt a LIFO (last-in-first-out) accounting basis to measure the marginal costs of their inventory and exploit the increased cost of newer inventory. LIFO accounting (in contrast to FIFO (first-in-first-out)) will lead to a higher marginal cost number in inflationary times as the retailer's cost for the most recently purchased products will obtain. LIFO accounting will accordingly reduce the size of the retailer's markup—making the retailer's price seem more competitive. For a basic description of LIFO and FIFO accounting methods, see H. SELLIN, ATTORNEY'S PRACTICAL GUIDE TO ACCOUNTING 5-30 to 5-35 (1965). However, if a uniform standard is set or if retailers uniformly opt for the same accounting basis, then comparable cost data will be generated. Many other features of standard accounting principles will work to provide similarly useful cost data.

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real. In some markets a large degree of vertical integration (or induced vertical integration) would militate against markup disclosure intervention. Still, it is unlikely that requiring markup disclosure would cause General Motors to merge with the hundreds of its independent dealer franchises throughout the country.[113] Even if vertical integration were complete, it might be possible in some industries to still develop informative accounting principles for estimating marginal or unit costs. As discussed above,[114] it is more difficult to calculate marginal costs for manufacturers than for retailers. But evolving accounting principles—informed by historical practice and the costs of unintegrated competitors—might resuscitate the utility of cost disclosure even in integrated industries. Vertical integration increases the difficulty of calculating a true marginal cost, but there still remain many markets in which independent retailers refuse to reveal readily known cost information.

2. *Manufacturer Rebates.*—Manufacturer rebates also increase the difficulty of estimating marginal cost. In the new car market, U.S. manufacturers routinely give back to dealerships "rebates, bonuses and incentives" based on the number of cars sold in a particular sales period. The rebates can amount to two or three percent of the dealership's initial cost.[115] Thus, the dealership's true cost for a car is the amount originally paid the manufacturer (the dealer's invoice) minus the amount the manufacturer subsequently rebates to the dealership. Standards for markup disclosure would have to account for such rebates.

Establishing such standards would be difficult but not impossible. While retailers would have an incentive to underestimate the expected rebate to inflate their marginal cost estimate,[116] they could be forced to accurately disclose such expected rebates and include shortfalls in future periods much as is done with estimated taxes. A regulatory movement toward mandatory disclosure may also induce car manufacturers to in-

113 It is possible that retailers could create dummy corporations to buy from the manufacturer and sell to the retailer at an inflated price. This practice would deflate the markups of the downstream retailers. While this example shows that regulations would need to be particularly sensitive to the circumvention efforts of retailers, it would be fairly easy to eliminate this specific type of evasion by forcing retailers to reveal the markup based on the costs of whomever first buys from the manufacturer. By basing the dealer's cost on this first transfer price, a regulation could eliminate the incentives for sham "middlemen" corporations that provide no valuable services—while allowing consumers to directly judge whether post-manufacturer profits are justified by post-manufacturer services.

114 *See supra* note 98 and accompanying text.

115 *See* R. SUTTON, *supra* note 73, at 195.

116 In the new car market, dealers as the buyers of trade-ins have an additional incentive to underrepresent to the used car seller the price at which the dealer will subsequently sell the car ("I will only be able to resell your car for $500"). The analysis of this Article, however, might be extended to the trade-in market. An analogous regulation, for example, might require a dealer to reveal to the used-car seller the intended resale price for the car—and then require the dealer to actually offer the trade-in at that price for a specified period (perhaps two weeks).

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crease the extent and complexity of rebate programs to undermine the workability of markup disclosure regulation. Responsive regulation could, however, limit these strategies. Fines could be introduced for systematic underestimation; unaccounted rebates could by law be passed on to the consumer; or firms could be forced to allocate unaccounted rebates to reduce their cost estimates on future sales.[117]

3. *Induced Collusion.*—Another problem may arise if cost disclosure induces collusion among retailers. The benefits of markup disclosure would be seriously reduced if disclosure induced or facilitated such activity. Public disclosure of retailers' costs might make it easier for retailers to reach and enforce a collusive agreement in that they could more rationally decide how to divide the market and assess the incentives of individual retailers to breach an agreement.[118] Policymakers should therefore assess the likelihood that cost disclosure would facilitate collusion. In many retail markets, however, retailers already have knowledge about their competitors' costs. Only the consumers are in the dark.[119] In such situations, promoting cost disclosure would have a negligible impact on retailers' ability to collude.

Returning to the example of the car market, there is strong reason to believe that the net effect of cost disclosure would be pro-competitive. The high cost of bargaining for cars at individual dealerships dramatically reduces the amount of competition among different dealerships. A rational salesperson knows that it will be difficult for any consumer to visit more than a small number of dealerships—since it currently takes more than an hour per dealership to find out the "real" price. Thus, even though there may be several dealerships in a city, an individual dealer knows that any customer in its showroom is likely to visit only a few of its competitors. These high bargaining costs serve to divide up the market and give individual dealerships local monopolies (or oligopolies) over the potential customers in their showroom. Markup disclosure, however, serves not only as a substitute for search, but reduces the cost of further search at other dealerships.[120] Thus, markup revelation is likely to place

117 A tricky issue remains about what part of a rebate is attributable to an individual car. If the monthly rebate program is "progressive," then the final cars purchased in the month have larger implicit rebates (the size of the marginal rebate is increasing). Indeed, this may explain why dealerships are often inclined to give better deals at the end of the month. R. SUTTON, *supra* note 73, at 197.

118 To collude successfully, firms in an industry must be able to reach agreement, detect breaches of the agreement, and punish firms that breach the agreement. The disclosure of information about retailers' costs might be a "facilitating practice" that make collusion easier. *See* Ayres, *supra* note 81, at 316.

119 For example, car dealers can get estimates of their competitors' costs simply by buying an *Edmunds* manual. *See supra* note 35.

120 *See supra* note 49 and accompanying text.

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individual dealerships into actual competition with a larger group of dealerships and therefore heighten competitive rivalry.

4. *Distorted Consumer Competition.*—Finally, mandating standardized disclosure may distort market behavior by both consumers and sellers. If the standards are only imperfect proxies for product quality, then consumers, relying on the standard, may mistakenly choose inferior products. Manufacturers may in turn exacerbate this distortion by altering their products in ways that satisfy the standard but actually reduce product quality.[121] For example:

> the [Recommended Daily Allowance (RDAs)] were devised on the assumption that, by obtaining the RDA of major nutrients from natural sources, we would also obtain sufficient amounts of trace elements. However, manufacturers have responded by fortifying natural products with synthetic vitamins, so that the assumed relationship between major and trace nutrients may no longer hold. As a result, products which score well may not be the products which are most nutritious on balance.[122]

Supply-side distortions of this kind have arisen in connection with a number of ill-conceived disclosure standards.[123]

Promulgating standards for markup disclosure may similarly act to distort market behavior. On the demand side, if consumers pay more attention to the size of the markup than to the price of the product, retailers will have less incentive to search for the best wholesale price. At the extreme, retailers would not invest any resources in lowering the price they paid manufacturers, confident that they could pass on any price to consumers as long as they kept their markup sufficiently low.

Further, consumers focused on the size of the markup might begin to ignore the quality of retail services. Retailers forced to compete on markup size might be forced to unduly scrimp on the fixed costs of retail production. Low-volume products that necessarily have higher inventory costs might be driven from the market and retail services that were not reflected in the seller's marginal cost would be limited.

In each of these examples, misinformed consumers may rationally make inefficient choices that induce inefficient seller behavior. The threat of consumer distortion may not be great because a knowledge of the sale price gives consumers a backstop measure of value. Rational consumers would not be mesmerized by markup disclosure and forget about either the actual sale price or the value of retail services. Because consumers

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121 *See generally* Beales, Craswell & Salop, *The Efficient Regulation of Consumer Information*, 24 J.L. & ECON. 491, 525 (1981).

122 *Id.*

123 It is possible that cigarette manufacturers, in an effort to reduce tar and nicotine content (which must be disclosed), have failed to reduce carbon monoxide levels and hence the total toxicity of cigarettes. *Id.* Thus, "to the extent that consumers rely on the index (at the expense of other data), sellers will seek to maximize their rating at minimum cost namely, by improving only those attributes given the most weight in the index." *Id.*

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can directly experience the quality of many retail services,[124] higher markups that are related to higher retail services (including higher retail inventory costs for specialized, low-volume products) should not deter consumption. However, it is only honest to concede that since consumer ignorance and misperception can cause an unregulated market to fail, these same traits might serve to undermine or distort "enlightened" market intervention. Policymakers should accordingly be attuned to the real world consequences of markup disclosure.

IV. CONCLUSION

In a limited set of markets, consumers value markup information. Notwithstanding this fact, most retailers refuse to disclose it. The failure of the market to provide consumers with information about the seller's cost inefficiently increases the costs of search and inequitably increases the amount of price dispersion among consumers. We have argued that the law can improve the equilibrium in these markets by encouraging markup disclosure.

In a pragmatic way, our analysis suggests which markets should be the targets of government intervention. Policymakers should first look at the "demand" side to identify markets in which consumers will particularly value markup information. We have suggested that a knowledge of the seller's cost will only be relevant in "thin" markets—markets in which consumers would rationally search for information about the market price. Policymakers can identify thin markets in several ways. First, such markets will often be characterized by price dispersion (different retailers will sell the same good at different prices). Second, markets in which consumers bargain over the selling price are necessarily thin. Finally, and most directly, one can look to see the extent to which consumers actually search for information about the best price among retail competitors. Consumer search will be most likely if consumers only infrequently purchase a product or if the product is sufficiently heterogeneous that spot prices will not develop.[125] In such thin markets consumers will value markup information as a substitute for search. A consumer offered a product five percent above retailer's cost is less likely to continue searching than a consumer who has an offer with a fifty percent markup.[126]

In his path-breaking article *The Economics of Information*, George Stigler noted that "[p]rice dispersion is a manifestation—and, indeed, it

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124 See discussion *supra* note 58 and accompanying text.

125 Consumers need to search for Persian rugs, for example, because although they are largely substitutes, they are sufficiently heterogeneous that uniform pricing would not obtain.

126 *See supra* note 55 and accompanying text (a discussion of how consumers relying on directly observable information concerning retail services can use markup information to guide length and intensity of their search).

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is the measure of ignorance—in the market."[127] Stigler was speaking about market price ignorance: consumers won't buy from one manufacturer if they know they can get a better deal elsewhere. One contribution of this article, though, is to show that knowledge about a retailer's markup can serve as a proxy for knowledge about the market price.

After identifying markets in which consumers will rationally value markup information, regulators should next look to the "supply" side to determine why retailers fail to provide this information. We have argued that the type of regulatory intervention should be tied to the specific causes of market failure. In many instances, the costs of credibly and effectively revealing markup information will keep retailers from passing on this information to consumers. The current practice of many car dealerships to offer to sell cars "$1 above their invoice" cost is especially persuasive evidence of this type of market failure. Dealers obviously think this type of information is relevant to consumers' purchasing decisions or they wouldn't emphasize it in their advertising.[128] But the accepted practice of lying about dealer's cost makes it much more difficult to tell the truth. Consumers discount all markup representations so that a dealership revealing a higher truthful markup may actually put itself at a competitive disadvantage. In such markets, outlawing markup misrepresentation and establishing uniform standards for voluntary markup disclosure may, by itself, be sufficient to engender markup disclosure.

Some retail markets, however, may fail to disclose markup information for reasons unrelated to the costs of credible and effective communications. Retailers in bargaining markets may particularly prefer to withhold information about the size of their markup in order to get a bigger piece of the pie. If a significant proportion of the consuming public fails to bargain aggressively, retailers in a bargaining market may prefer to retain their "sucker" sales rather than move to an equilibrium with less price dispersion. In these situations, mandatory disclosure requirements may be necessary to bring about markup revelation.

This Article has focused on the new car market as a prime target for regulatory intervention. But other markets might benefit from markup regulation. For example, in *Frostifresh Corp. v. Reynoso*,[129] a consumer bought a combination refrigerator-freezer from a retailer for $1145.88 and then refused to pay the full contract price. At a trial for the unpaid balance, the plaintiff-retailer "admitted that cost to the plaintiff corporation for the appliance was $348.00."[130] The trial and appellate courts

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127 Stigler, *supra* note 48, at 213-14.

128 A similar argument undermines Richard Posner's contention that borrowers do not value information about the interest rate. *See* Donohue & Ayres, *supra* note 106, at 802 n.50 ("[T]he widely advertised interest rate competition among car manufacturers is prima facie evidence of the informational value in disclosing interest rates.").

129 52 Misc. 2d 26, 274 N.Y.S.2d 757, *rev'd*, 54 Misc. 2d 119, 281 N.Y.S.2d 964 (1967).

130 *Id.* at 27, 274 N.Y.S.2d at 758.

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struggled to determine the proper remedy for this unconscionable 325% markup.[131] We suggest, however, that fewer contracts of this kind would be written in the first place if consumers knew the size of the markup. At minimum, markup disclosure will tend to reduce price dispersion by driving out unconscionably high markups.[132] The Reynosos would have been less likely to buy the refrigerator-freezer if they had known the seller's cost. The *Frostifresh* example suggests that retail markets in which "shady" sales practices lead to extortionary markups may be additional targets for mandatory markup regulation.[133]

Ultimately, these regulations may engender a form of markup competition in which retailers affirmatively attempt to attract consumers on the basis of low markups. Credible commitments to low markups could assuage at least one consumer fear—the fear of being ripped-off by a middleman.[134]

Finally, this Article has attempted to address some of the real difficulties in implementing the various markup regulations. The very forces that make unregulated retailers reluctant to reveal markups are likely to induce regulated retailers to resist markup regulation. Retailers may try to obfuscate and circumvent markup regulation by offering rebates or by vertical integration. Consumers may unduly emphasize markup information over other indicia of product quality (including retail services and even retail price). But notwithstanding these difficulties of implementa-

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131 The court fretted, "Does the court have the power under § 2-302 of the Uniform Commercial Code to refuse to enforce the price and credit provisions of the contract in order to prevent an unconscionable result?" *Id.* at 759; *see also* Ayres & Gertner, *supra* note 51.

132 High markups may be necessary to provide products on credit to consumers who are poor credit risks. Restricting the ability of sellers to charge higher prices will make them less willing to sell to poorer credit risks and such restrictions might ultimately hurt those very consumers that the laws are attempting to help.

Our proposals do not—unlike usury laws—restrict sellers from charging high markups. They merely require sellers to reveal the size of the markup to the consumers. If paying a higher implicit interest rate is in the best interest of higher risk consumers, they should be willing to sign even once the high markup is revealed. By claiming that markup revelation will drive out unconscionably high markups, we are implicitly claiming that many of the high markup concerns are driven not by credit risk considerations, but by the seller's ability to take advantage of consumer (markup) ignorance.

133 Regulators might want to target "tin men"—door-to-door aluminum siding salespeople. *See Tin Men* (Touchstone Pictures in association with Silver Screen Pictures II 1987); *see also American Home Improvement, Inc. v. MacIver*, 105 N.H. 435, 201 A.2d 886 (1964) (contract for installation of "Flint-Coat" siding with markup of 300% held unconscionable).

134 Thin markets can also exist for goods that consumers buy relatively frequently. Consumers, for example, regularly buy groceries, but supermarkets sell so many different items that it is difficult for consumers to retain detailed comparative knowledge about the best price for 40,000 different goods. Some supermarkets respond by advertising the "lowest weekly food bill." *See* Note, *Rationalizing Antitrust Cluster Markets*, 95 YALE L.J. 109, 120 n.50 (1985) (by Ian Ayres). Markup competition might more credibly allow consumers to search for the best price. Unit pricing that included markup information would let consumers better assess whether their preference for one-stop shopping should outweigh an unusually high markup on a particular item. Supermarkets might more rationally commit to selling no good at more than a 10% markup.

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tion, the benefits from markup disclosure are great. The frustration that many consumers experience in buying a car is largely attributable to the ludicrously inefficient manner in which cars are marketed.[135] A targeted policy toward promoting markup disclosure could, in a small way, improve our quality of life. For the sake of efficiency, disclosure might reduce the amount of time consumers need to bargain and search for a car. For the sake of equity, disclosure might reduce the chance that consumers would be caught paying outrageous markups. This strong convergence of equity and efficiency argues in favor of considering legal policies which promote markup disclosure.[136]

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[135] *See, e.g., Tin Men, supra* note 133 (Richard Dreyfuss bargains for a Cadillac and salesperson will not reveal the best price).

[136] Richard Posner noted:

> Social welfare legislation . . . is usually thought to involve a tradeoff between equity and efficiency, or between the just distribution of society's wealth and the aggregate amount of that wealth. If . . . equity and efficiency line up on the same side of the issue, these laws are considerably less problematic than they have seemed to some observers.

Posner, *The Efficiency and the Efficacy of Title VII*, 136 U. PA. L. REV. 513, 513 (1987).

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