VII
REMARKS AT WEDNESDAY MORNING SESSION UPON RECEIVING YOUNG SCHOLARS MEDALS

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The Wednesday morning session
of The American Law Institute
convened in the Grand Ballroom
of The Westin St. Francis, San Francisco, California,
on May 18, 2011.
President Roberta Cooper Ramo and
The Honorable William A. Fletcher,
Chair of the ALI Young Scholars Medal Committee,
presided over the awards ceremony.

President Ramo: Ladies and gentlemen, if everyone would please be seated.

It is not only an honor, but I am thrilled that we have come to this day, and it is a pleasure to introduce Judge Willie Fletcher of the Ninth Circuit, who was the Chair of our first Committee to select the first American Young Scholars.

Judge William A. Fletcher (Cal.): Good morning. Thank you, Roberta, and thank you, Lance, for tricking me into chairing this Committee. (*Laughter*) When I said yes, I immediately regretted it. But then I discovered, to my enormous pleasure, that the task was both very educational and very satisfying.

I begin by acknowledging and thanking the members of our Committee. We had to expand the Committee, part way through the process, because of the large number of applicants. In alphabetical order: Judge Morris Arnold of the Eighth Circuit; Professor Kate Bartlett of Duke University School of Law; Ms. Sheila Birnbaum of Skadden, Arps; Mr. George Davidson of Hughes Hubbard & Reed; Professor John Donohue of Stanford Law School; Professor Rochelle Dreyfuss of NYU School of Law; Professor Richard Fallon of Harvard Law School; Mr. Conrad Harper, now of counsel at Simpson Thacher, formerly Legal Adviser to the State Department, and formerly counsel to anything else you might care to name; Justice Jack Jacobs of the Supreme Court of Delaware; Ms. Michele Kane of the Walt Disney Company; Professor Daniel Richman of Columbia Law School; and Professor Paul Stephan of the University of Virginia School of Law. Finally, as if she did not otherwise have enough to do, Roberta Ramo was also on the Committee, reading right along with the rest of us.

We had 71 candidates for the Young Scholars Award, proposed by their various law schools. Faced with that number, we were just staggered. Not only did we have to read their résumés and the cover letters sent by their deans. We had to read two, sometimes three, and occasionally four substantial articles submitted by each candidate. We divided up into teams with expertise in various subject matters, two on each team. For example, Dick Fallon and I were on one team, reading the articles in the areas in which we are supposedly expert. Each team then recommended one and sometimes two candidates from each field. The entire Committee then read all of the articles written by all of the top candidates from these fields. Finally, we met in New York to discuss the candidates.

We were extraordinarily impressed by the quality of work that is being done by young legal scholars. All of them, not only the winners. I have to say that not only was I impressed. I was surprised. I shouldn't have been, but I was. I expected the work to be very good, but it was much better than I even expected.

Let me take a moment to try to explain how the two scholars we are honoring today, and the work they have done, fits into the work of The American Law Institute, as well as into the work of the legal academy.

First, The American Law Institute. For some of you, this is familiar history. For others, it may not be entirely familiar. I will start with Swift v. Tyson [41 U.S. (16 Pet.) 1 (1842)]. (*Laughter*)

The Court decided *Swift* in 1842, based on a general common law that all lawyers of the time took for granted, but applied that law in a slightly new circumstance. In later years, *Swift* came to be seen (primarily by its late 19th-century and early 20th-century detractors) as having created general common law in the federal courts out of whole cloth, but this view was based on an ignorance (perhaps willful) of our legal history. Beginning in 1789 and lasting until the Supreme Court's decision in Erie Railroad Co. v. Tompkins, in 1938 [304 U.S. 64 (1938)], the federal courts applied general common law in areas such as commercial contracts, marine insurance, and negotiable instruments. The general common law was not binding federal law. State courts were free to follow it, or not, as they chose. The general common law proved to be enormously successful in the first half of the 19th century, providing a mechanism for voluntary cooperation among the various common-law courts, including the United States Supreme Court in diversity cases. The general common law, one part of which had been applied in *Swift*, gave us for many years a remarkably uniform common law in federal and state courts.

The uniformity of the general common law began to break down after the Civil War. The federal courts became increasingly conservative, with many of the judges having served as railroad lawyers before coming on the bench, and the economic interests of the states increasingly diverged. Some were creditor states, some debtor states. Some were urban states, some agrarian states. The system of general common law became increasingly dysfunctional. The common-law rules followed by the federal courts often differed from those followed by the states in which they were located, and the common-law rules followed by the state courts often differed from state to state. A litigant could sometimes get a different rule of law depending on which side of the street the suit was filed—that is, depending on whether the suit was filed in federal or state court.

Seeing this increasing disuniformity, the founders of The American Law Institute hit upon a brilliant idea. The Institute was founded in 1923 (15 years before *Erie*) to provide a new mechanism to help the state courts coordinate their efforts to achieve consensus on the common-law rules to follow. That is the origin of the Restatement of Contracts, the Restatement of Torts, and so on. The relative uniformity of the common law among our states is due, in significant part, to these Restatements.

The founders of the Institute had the wit from the very beginning to realize that the work of the Institute should not be the work merely of judges, merely of lawyers, or merely of academics. Rather, it should be the work of all of these groups. So all three were brought together in the common endeavor of creating the Restatements.

To some extent, the Institute has been the victim of its own success. The Restatements have been so successful, and the vitality of the Institute so great, that the Institute has begun to look for other work—that is, work in addition to summarizing and restating doctrinal common-law rules. In recent decades, the Institute has increasingly branched out, occasionally producing draft statutes, as in the Federal Judicial Code Revision Project, for which I had a bit part as one of the Advisers. Another example is the Principles of Corporate Governance, which went well beyond doctrinal analysis and synthesis. This new work is true to the ideals of the Institute, and draws on the expertise of the three groups that have always been at its heart, but it has a broader focus. It is educated and practical-minded, and not doctrinal in the old Restatement sense.

The work of the two young scholars we honor today fits into this new phase of the Institute's work. You will see this clearly in a moment when I introduce them and describe their work.

Second, the legal academy. There is a danger of disembodied, ivory-towerish doctrinal work in the academy. The Institute has largely avoided this pitfall because of its insistence on the involvement of lawyers with their sense of the real world, and of judges with their slightly different sense of the real world. But it is a real danger in the academy.

There is an old joke. Many of you have heard it, but I will use it as an entree into what I am about to say. A man is searching under a streetlight at midnight. Someone comes along and says, "What are you looking for?"

"My wallet."

"Did you lose it here?"

"No. I lost it down the street."

"Why are you looking here?"

"The light is better." (*Laughter*)

This describes legal scholars who simply go to the library. It is so much easier to go to the library and read the casebooks, and to do legal scholarship based on the premise that if it is not in the reported cases it does not matter very much. That is not the best scholarship, and it is not the way of the Institute. Good legal scholars have always sought to go outside the library. We can see this in several movements in law schools over the years. In the 1960s, we saw a movement to get psychiatrists and psychologists into the legal academy, and partly as a result we got changes in the insanity rules in the D.C. Circuit. This movement, however, has not turned out to have much staying power. When the psychiatrists and psychologists retired, most of the major law schools did not replace them.

A second, much more successful movement has been law and economics. It started out with a few giants—among them, Ronald Coase, Guido Calabresi, and Richard Posner—who had powerful insights into the relationships between legal rules and economic principles. I am not a law-and-economics person, but I have to say that I think the movement somewhat stalled after these scholars did their work. We incorporated their enormously valuable insights into our thinking. But then what? The recent, and successful, answer has been a focus on behavioral economics. If you want a best-selling book, you can call it "freakonomics."

The law-and-economics movement has had great staying power. We now have, on all major faculties, numerous people educated in economics. On a law faculty of, say, 50 at a major law school, we will probably find at least five Ph.D.s in economics, sometimes more than that.

A third movement, somewhat more fragmented, has been law and science. Fragmented because there are so many kinds of science, and, relatively speaking, so few law-faculty slots for scientists. But science is necessary to an understanding of certain fields of law. We often find two or three people with Ph.D.s in scientific subjects. We have two winners of the Young Scholars Award. I say two winners. I want to make sure that you understand that, even though we are hearing in a sustained way only from one of them, we have two winners. We don't have a first and second place. We have two winners. We have chosen to have them address you one by one. Professor Bar-Gill will address you today. Professor Fromer will address you at our Annual Meeting next year.

Professors Bar-Gill and Fromer fit beautifully into the new phase of the work of the Institute. And they fit beautifully into the "law-and" part of the legal academy. Professor Bar-Gill is very familiar with the line of economics that is represented by Coase, Calabresi, and Posner, but he is also familiar with—and has done much of his work in—behavioral economics. Professor Fromer is very well educated in science. Her primary work is in intellectual property, particularly patents, where her scientific expertise can be brought to bear. We are very proud to introduce them as the Institute's first winners of our Young Scholars Award. They are emblematic of our desire to honor young scholars, and to incorporate their work into that of the Institute.

I first would like to introduce Professor Jeanne Fromer. She will be our principal speaker next year, but she will say a word or two today. Professor Fromer was an undergraduate at Barnard College of Columbia University, graduating in 1996 with a *summa cum laude* degree in Computer Science. She then went to MIT, where she got a master's degree in Electrical Engineering and Computer Science. She did not go on to the Ph.D. because she finally realized that the future of the world is in the hands of the lawyers. (*Laughter*)

Professor Fromer went to Harvard Law School, graduating *magna cum laude* in 2002. While in law school she was, among other things, a teaching and research assistant to our very own Professor Daniel Meltzer. She went on to clerk for Judge Sack on the Second Circuit, and then for Justice Souter on the Supreme Court. She has been an associate professor at Fordham University School of Law since 2007.

Our Committee analyzed three articles she wrote on patent law. One was a 2010 article in the *NYU Law Review*, called "Patentography" [85 N.Y.U. L. Rev. 1444 (2010)], describing the importance of where a patent suit is brought and making suggestions for rationalizing the venue rules. Another was a 2009 article in the *Chicago Law Review*, called "Claiming Intellectual Property" [76 U. Chi. L. Rev. 719 (2009)], reframing the concept of claiming. The third was a 2009 article in the *Iowa Law Review*, called "Patent Disclosure" [94 Iowa L. Rev. 539 (2009)]. Some academics have argued that disclosure of information about the patent is not particularly important. Professor Fromer makes, to my mind, a persuasive case to the contrary. I am honored on behalf of The American Law Institute to award the Young Scholars prize to Jeanne Fromer. Here is a nice plaque to put on the wall, and here is a nice check to put in the bank. (*Applause*)

I give you Professor Fromer.

Professor Jeanne C. Fromer (N.Y.): Thank you. Thank you so much. I am incredibly flattered and frankly quite floored to receive this honor.

Judge Fletcher stole my thunder, because I wanted to thank all of the incredible and supportive mentors that I have had throughout the years, starting with law school. I was doing a Ph.D. in computer science, and I did wake up and realize that the law is where the action's at, and I took a leave of absence and I haven't looked back. But since the moment I got to law school at Harvard and on throughout my career, whether in my limited time in practice, my clerkships, and in my time in academia, I have had such supportive people guide me and teach me. That started really the first week of law school with Professor Dan Meltzer, who was my criminal-law professor and for whom I served as a teaching assistant and research assistant and I have kept in touch with as a friend, and he has been a great mentor to me through the years. So since he is here today, I decided I wanted to embarrass him directly, but there have been really a lot of incredible mentors that I have had, and I really thank them for helping me get to where I'm at today, and I am really incredibly honored to be standing here and to have the opportunity to work with The American Law Institute.

I have seen the ALI and the things it's produced, like the Restatements, which have been this black box to me, this incredibly helpful black box as I teach Contracts. And as I see the ALI's work moving more into intellectual property—I know there have been some recent projects in the past few years—I am really incredibly honored and excited to have the opportunity to be involved with the ALI in the future, and I look forward to talking to you next year about my work. Thank you. (*Applause*)

Judge Fletcher: Thank you very much, Professor Fromer.

The other winner is Professor Oren Bar-Gill, who teaches at NYU. You will have noticed a certain imbalance. Both winners are from New York. Maybe this was an attempt to balance the fact that the Meeting this year is on the West Coast.

Professor Bar-Gill is a professor at New York University School of Law. He got his B.A. in economics, *magna cum laude*, from Tel-Aviv University, in 1995; an LL.B., *magna cum laude*, from Tel-Aviv University School of Law in 1996; an M.A. in law and economics, *summa cum laude*, from Tel-Aviv in 1996; an LL.M. from Harvard Law School in 2001; a Ph.D. in economics from Tel-Aviv in 2002; and an S.J.D. from Harvard Law School in 2005. He finally ran out of available degrees. (*Laughter*) Professor Bar-Gill started as an assistant professor at NYU in 2005, was promoted to associate professor in 2007, and has been a professor since 2009. He is the director of the Lederman/Milbank Fellowship Program in Law, Economics and Business. Since 2009 he has been co-director of the NYU Center for Law, Economics and Organization.

The Committee read four of Professor Bar-Gill's articles. The common theme of all of them is the imbalance of information and power between sophisticated players and consumers. This theme is prominent in an article on the psychology and economics of subprime mortgages [*The Law, Economics and Psychology of Subprime Mortgage Contracts*, 94 Cornell L. Rev. 1073 (2009)]. His description of the behavior of the lenders is rather gentle. He calls it "a rational market response to the imperfect rationality of [the] borrowers." [Id. at 1079.] Now lay people might say it somewhat differently. They might say it is lenders taking advantage of suckers. But Professor Bar-Gill's way of putting it does not stem from either a lack of sympathy for the borrowers or the situation in which they find themselves. The Committee was fascinated by another article Professor Bar-Gill wrote in the *Northwestern Law Review* in 2004, on essentially the same topic, but with the focus on credit cards rather than mortgages. The title of the article, "Seduction by Plastic," may give you some sense of where his sympathies might lie [98 Nw. U. L. Rev. 1373 (2004)]. Another article, "Mobile

Misperceptions," applies the same analytic technique to mobile-phone contracts [(with Rebecca Stone) 23 Harv. J.L. & Tech. 49 (2009)].

Professor Bar-Gill's fourth article is "Making Credit Safer," coauthored with Professor Elizabeth Warren, published in 2008 in the *University of Pennsylvania Law Review* [157 U. Pa. L. Rev. 1 (2008)]. The article suggests that certain forms of credit can be regulated in much the same way we regulate the physical consumer products such as lawn mowers. That is, there are certain inherently dangerous features of credit that could be regulated to make it a safer product. Why should a credit card be a nonregulated product when we regulate the safety of physical products?

We are honored to have Professor Bar-Gill as our first speaker. We chose him as our first speaker because we think his topic is more likely to be relevant to the politics of this year. We think that patent law, the specialty of Professor Fromer, is more likely to be relevant to the politics of next year.

I give you Professor Bar-Gill. (*Applause*)

Professor Oren Bar-Gill (N.Y.): Thank you very much, Judge Fletcher. It is a great honor to be here. It is a great privilege to speak to this distinguished audience about consumer psychology and consumer protection, and it will be on the screen in a second, and then I will continue.

Thank you. So my work in this area is divided in a rough sense into two main parts. There is a positive descriptive part and a normative part. In the positive part or portion of my work, I try to get a better understanding of the workings of consumer markets.

The underlying insight is that consumers are imperfectly rational, and this imperfect rationality of consumers interferes with the operation of market forces. It prevents these market forces from guaranteeing efficiency and protecting consumers. Basically, we have a market failure, what I like to call a behavioral market failure, and, when we have a market failure, it makes sense to ask what the law can do to help, and this is where I get into the normative part, try to explore this question.

But let me start with the descriptive. There is now a vast literature in psychology and behavioral economics dealing with this type of market failure. What I would like to do now is give you a small taste of the main results from this literature and the relevance to legal policy.

So if we are talking about tasting, let's start with some work on chocolate and fruit. So today is Wednesday, the 18th. Imagine that I ask you what you would like to have for dessert next week, on the 25th. When this question was posed to a less distinguished audience, 74 percent chose fruit, the healthier choice.

Now imagine that I am posing the same question but not today, a week in advance of the dinner, but on the very same day, on the 25th, I ask you, "What would you like to have for dessert today, fruit or chocolate?" Again, when posed to the less distinguished audience, now we see that 70 percent choose chocolate.

Now how can this be? I'm asking the very same question, "What would you like to have for dessert on Wednesday, the 25th?" The only difference is the timing of the question, on the same day or a week in advance, and we get very different responses. From a rational-choice economic perspective, this is a puzzle; it can't be.

The explanation is psychological, and it is the present bias, an instance of imperfect rationality. When we ask or when we need to make the decision a week in advance, all the costs and benefits are in the future and we can weigh them rationally. On the other hand, when we are asked this question on the 25th, what are we going to have for dessert today, the benefits of chocolate are in the present; the costs are in the future. Present bias kicks in and we make a different choice.

Now the distortions caused by present bias are not limited to decisions about what to have for dessert. They apply much more broadly perhaps even to more important decisions. Specifically they apply to decisions about how we use our credit cards.

A recent study attempted to measure directly the implications of present bias to credit-card debt. We can see the main results in the graph. What this graph shows is that the average balance on a credit card held by those with a high level of present bias is twice as large as the average balance held by those with a low level of bias.

Let me give you another example from the credit-card context. We are all familiar with those introductory offers that issuers send us, oftentimes with teaser rates, low interest rates for a while. Now it is in the interest of issuers to optimally design these teaser-rate offers so that they attract as many customers as possible. One way they do this is by conducting very large-scale real-world experiments.

So one issuer sends tens of thousands of credit-card offers with different types of teaser rates to consumers to see what takes, what they prefer. Specifically, the consumers were asked to choose between two types of teaser-rate offers, one with a 4.9 percent interest rate for six months and another with a 7.9 percent interest rate for 12 months. For both offers, the interest rate resets to 16 percent at the end of the introductory period. You would not be surprised to learn that many consumers chose the former, the 4.9 percent, six-months offer, and I will now tell you that, for many of these consumers, this decision was a mistake.

How do we know that it was a mistake? Because this bank and the economists working with it tracked these consumers over time. They followed their balances, and they saw how much these consumers paid in interest, and they calculated how much they would have paid in interest had they chosen the alternative 7.9 percent for 12 months offer, and many of them would have paid less.

Again, the culprit is present bias. When making the decision ex ante, the consumers are thinking we should not be borrowing at the end of the introductory period; we won't. But when the introductory period actually ends, the cost of paying off your balance in full right now is in the present, the costs of continuing to bear high-interest debt are in the future, and again, present bias leads to a skewed decision. So we have imperfect rationality distorting decisions, costing consumers money in the credit-card market.

Moving on to mortgages, perhaps one of the main problems with mortgages is the complexity of these products, especially if we look at the subprime mortgage contracts leading up to the meltdown. We cannot really expect the average imperfectly rational consumer to understand these products and to make appropriate decisions. In fact, regulators are currently trying to deal with this issue.

In terms of the research, another recent paper [Kristopher Gerardi, Lorenz Goette & Stephan Meier, *Financial Literacy and Subprime Mortgage Delinquency: Evidence from a Survey Matched to Administrative Data*, Working Paper No. 2010-10, FRB Atlanta, Oct. 8, 2010] tried to measure directly the relationship between the sophistication, or lack thereof, of consumers and borrowers and outcomes in the mortgage market, and here are some of the main results.

If you look at the fraction of borrowers who are behind on their payments, you will find that this fraction is two-and-a-half times larger for consumers who have lower numerical abilities, who are less sophisticated. If you look at the fraction of consumers who are entering foreclosure, you will see that this fraction is four times larger for those with lower numerical abilities, lower sophistication. Again, we see that imperfect rationality has a very large effect on outcomes in the mortgage markets, and it hurts consumers.

Moving on to cell phones. You may recall, a few years ago, when AT&T and Apple introduced the second-generation iPhone; now we're at generation four, but let's go back to generation two. They came out with these great ads that read: better, cheaper iPhone.

Now it was better because it was second generation. How was it cheaper? It was cheaper, or allegedly cheaper, because they reduced the up-front cost of the phone from $400 to $200, but at the very same time, they also increased the fixed monthly fee from $60 to $70, and recall this is a two-year lock-in contract, so it wasn't exactly a cheaper iPhone.

More importantly, the question is, why are so many consumers lured by free phones or subsidized phones, even though we understand that we are going to pay for these phones over time through the fixed monthly fee in these lock-in contracts? And again, the reason is present bias. We care more about saving money now, in the present, paying less for the phone; we care not enough about what we are going to pay over time.

A final example from the cell-phone market, and this comes from work that I did with my former student, Rebecca Stone, who is going to be clerking for Justice Breyer in the fall. In this work, we tried to quantify mistakes that consumers make in choosing between different plans. As we all know, there are many such plans, and they are very complicated and different on multiple dimensions. Making the right decision, choosing the right plan for you, is not trivial.

What we tried to do is to quantify this problem. We had some great data to do it with. We were able to track over 3500 subscribers, and, for each one of these subscribers, we knew exactly which plan the subscriber chose, and moreover, we knew how many minutes the subscriber spoke on the cell phone each month for over 20 months. With these data, we could calculate the total cost of cellular service for the subscriber given the chosen plan, and we were also able to calculate how much the subscriber would have paid had he chosen a different plan, and what we found is again quite surprising or striking.

We found that over 65 percent of cell-phone subscribers did not choose the right plan for them, they made a mistake. They could have saved money by choosing another plan that was available to them, and the reason, again, is imperfect rationality. It turns out that we have a very poor sense of how we are going to use our cell phones. We suffer from misperceptions, sometimes overestimating our future usage, sometimes underestimating it, and this leads us to mistakes in plan choice, and these mistakes are substantial.

Extrapolating from our data, we estimate that consumers are paying an extra $13 billion a year in the U.S. just because they are making these mistakes in plan choice.

Let me summarize the descriptive part. So consumers are imperfectly rational. They make mistakes. There is a market failure. Market forces that in other circumstances can generate efficiency, protect consumers, don't do it, and, because of this market failure, we need to consider what the law can do to help, so this is the normative part.

There are basically three approaches in this context. One is the do-nothing approach, the underlying premise being that markets, even when they fail, are better than what regulators and legislators can do. I'm not going to say any more about that.

The other two remaining approaches are what I call hard paternalism and soft paternalism, and let me talk a little bit about each.

Hard paternalism is the most heavy-handed form of intervention in markets. Basically, the idea is that we identify pricing structures, product features, practices that we deem to be bad, and we ban them, prohibit their use, and we actually have some important recent examples of such hard paternalism. If you look at the CARD Act of 2009 [the Credit Card Accountability Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (to be codified in scattered sections of 15 U.S.C.)], this Act bans double-cycle billing; it bans certain payment-allocation methods; it severely restricts risk-based pricing, limiting the ability to increase interest rates and to impose penalty fees; and it bans universal default.

If we move on to mortgages and look at the Dodd-Frank Act [the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, Pub. L. No. 111-203, 124 Stat. 1376] and the regulations that are implementing it, again we see severe restrictions on the use of prepayment penalties, we see an ability-to-repay requirement, we see a ban on no-doc loans. If we just look at these examples of hard paternalism, among them there are some practices that are clearly and universally bad and should be banned, but there are also other practices for which we are not so sure.

So as I mentioned, the CARD Act severely restricts the ability of creditors to engage in risk-based pricing. Economists would tell you that risk-based pricing is efficient. When a creditor gets new information about the riskiness of the borrower, it makes sense to incorporate this information in the price, sometimes increasing the price. Economists would tell you that not only is risk-based pricing efficient, it is also beneficial to certain groups of consumers, and this is a main problem with hard paternalism, with banning products and practices. While we may, indeed, be helping certain groups of consumers, at the same time we may also be hurting other groups of consumers, and it is oftentimes very difficult to accurately assess the net costs or benefits of this type of regulation.

More importantly, I want to suggest that there might be a way to avoid this difficult problem. There might be a way to help the consumers that we want to help without imposing excessive costs on other groups of consumers, and this is where soft paternalism comes in. And this is closely related to what Cass Sunstein and Richard Thaler call "nudging," for those familiar with the book [NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS (2008)].

Let me give you two examples of the main tools in the arsenal of soft paternalism, and I want to start with disclosure regulation. Disclosure regulation, when properly designed—and this is an important qualification because arguably many disclosure mandates that we have are not properly designed. When we have disclosure that is properly designed, this regulation directly targets the market failure that I have been talking about. It directly targets the imperfect information and the imperfect rationality of consumers, undoing or bypassing the effects of this market failure.

Now, in order to get disclosure regulation to be effective, it has to follow, in my opinion, one of two tracks. The first approach is to have very simple disclosure targeted at consumers. This disclosure has to be simple because consumers are imperfectly rational.

A good example here is the APR disclosure. The APR disclosure was originally designed to take the multiple or the multidimensional costs of credit and fold it into a single number, so that the only thing consumers need to do is to look at the APR of one product, the APR of another financial product, and choose the product with the lowest number. Even imperfectly rational consumers could be expected to be able to do that.

If we look at cell phones, what we could have is a disclosure mandate that requires carriers to provide a single number, the total cost or the annual cost of cellular service. So again, the consumer will compare the annual cost under one plan, the annual cost in another plan, and choose the plan with the lower cost. Importantly, this annual-cost figure has to incorporate not only product-attribute information, information on prices and fees, but also product-use information, information on how consumers are going to use their cell phones over time, and fold all this, again, into a single number. So this is one approach, simple disclosure, targeting consumers.

Another approach is a much more complete, comprehensive, and complicated disclosure but disclosure that is targeted at sophisticated third-party intermediaries rather than directly at consumers. Again, to exemplify from the cell-phone market, we could require carriers to disclose in electronic form, in computer files, to consumers their use-pattern information over the previous two, three years, information the carriers have. Now we would not expect consumers to go through this file and analyze it, because they are imperfectly rational. But the consumer could take this file and give it to a third-party intermediary who would then combine the use-pattern information with publicly available information on different plans that are being offered in the market. This way, the intermediary could recommend the plan that is best for this consumer given her specific use patterns.

So these are two approaches by which disclosure can undo the market failure and facilitate the efficient operation of market forces, rather than simply replacing them with command-and-control regulation.

Another tool in the soft-paternalism arsenal is safe harbors, plain-vanilla products, or other things falling under similar titles. A recent example is the "qualified mortgage" that appears in the Dodd-Frank Act [See, e.g., § 1412] and the Federal Reserve regulations. It is important to contrast this mode of regulation with the hard-paternalism alternative.

Assume that we think that 2/28 hybrid ARM [Adjustable Rate Mortgage] mortgages are risky and bad. Hard paternalism would simply ban these products altogether. Under the alternative soft-paternalistic approach, these products would be available, but they would be subject to heightened regulatory scrutiny, specifically as compared to simpler products like the fixed-rate mortgage, which would fall under the safe harbor.

Now if there are consumers, and arguably there are consumers who benefit from these products, these consumers would not be able to purchase them under the hard-paternalistic approach; they would be able to purchase them under the soft-paternalistic approach.

So let me briefly conclude. Consumers are imperfectly rational. We make mistakes. There is a market failure. There is room for the law to intervene. My suggestion is that, before we go down the hard-paternalism path, we try soft-paternalism strategies and techniques because, in many cases, they can accomplish much at a relatively low cost. And I look forward to your questions and comments. (*Applause*)

Judge Fletcher: If anyone has questions or comments for Professor Bar-Gill, please feel free. Seeing—oh, just in time.

Mr. Anton G. Hajjar (D.C.): I am wondering if you have an example of the disclosure through intermediaries. I think you had something on your screen, but I didn't understand if that was pointing to an actual real-life example.

Professor Bar-Gill: So what you saw on the screen, and this was a reference to a rulemaking process by the Federal Communications Commission that is under way, and in the Notice of Inquiry issued by the FCC, it specifically mentions the potential benefit of electronic disclosure working through intermediaries.

Let me give you a more concrete example of how this could work. Now there is a company called Billshrink.com. What this company does, this is its business model, it offers consumers this intermediary role to help you choose the right cell-phone plan or the right credit-card product for you. Now Billshrink has realized that it is critical for them to have information about use patterns in order to give valuable advice to their clients, but currently they don't really have the tools to do this. So, initially, they would just ask their clients, "So how do you use your cell phone?" But we already know that consumers don't really have a very good sense of how they're going to use their cell phone.

So then Billshrink started asking consumers to give them their user name and password, so they can log in, in their name, on the websites of the carriers, and download the PDFs of the monthly statements and extract information from these statements.

Now this is extremely inefficient. Things would be much simpler if the consumer had all this information in database form in an electronic file and could simply provide it to Billshrink. So those are the examples that I—

Mr. Hajjar: And that actually exists, Billshrink?

Professor Bar-Gill: Billshrink actually exists, I haven't made it up. The electronic files that could be given to Billshrink do not yet exist.

Mr. Hajjar: And then we're going to, I suppose, have to have someone who is going to vet all the competitors of Billshrink that are going to offer some variation on it.

Professor Bar-Gill: So here we have to—again, so I am not an anti-market person; I believe that markets can do a lot of good.

Now if we have competitors—there are other companies in addition to Billshrink. If we have a market for these intermediaries giving advice to consumers, those that give better advice, over time, are going to get more business. So they should try to get the better models for processing this information and translating it to advice for consumers.

Mr. Hajjar: Thank you very much.

Judge Fletcher: Microphone 1 and then 6.

Mr. Michael Greenwald (Pa.): I am just curious as to whether your research has gotten into the particularly thorny matter of health care. Now I know there are people who have argued that consumers are capable of making rational choices about health care. I am very skeptical about that, given the fact that it involves often very crucial decisions in very difficult circumstances, but I am curious to know if you think your research could lead to at least some soft paternalism in that area or not.

Professor Bar-Gill: Personally, I have not done research on health care because it's too complicated for me, not only for the average consumer; I am a below-average consumer. But definitely, behavioral economics is relevant for this topic, and there has been research in behavioral economics about health care.

The policies and the approaches that I have been talking about can be applied in this context as well. The main problem here is complexity. It is just too complicated for consumers to figure out. So if we could come up—and I'm not saying that this is easy or trivial—if we could come up with these types of total costs or single-number disclosures that can boil everything down into something simple that consumers can actually process and use, then this would be a step in the right direction, but, as I said, I have not done research on this and haven't given it enough thought.

Judge Fletcher: Microphone 6, please.

Professor Solangel Maldonado (N.J.): Hi. Thank you for that wonderful presentation. My question is, if consumers are imperfectly rational, but they are also unrealistically optimistic, will disclosure be sufficient to get them to change their behavior? So, for example, I think if you show consumers their average cell-phone use for the last two years, many consumers will think, well, I've been using many minutes, I'm going to change my usage. Or I have had this experience with texting plans, well, I'm not really going to, although this month I may have sent 340 texts, I'm really going to keep it down to 200 or less. So what can the law do to help consumers who are unrealistically optimistic?

Professor Bar-Gill: Thank you very much. That's a great question. Optimism is part of the imperfect rationality that I talk about, and your question powerfully suggests that the solutions that I have been suggesting are not a cure-all; they will not fix everything, but let me say something beyond that.

It is true, and there is much research about the optimism of consumers and individuals more generally. Now the degree of optimism or the extent to which optimism is a problem, however, will vary by context, so we are especially optimistic when we are presented with information about averages, about statistical information. We will always say we're above average. As you know, everybody is an above-average driver, and nobody will ever get divorced when you ask them in advance. So when you are faced with statistical information, you will always be or many of us will be optimistic, and that is why disclosure of statistical information is less likely to be efficient.

I kind of very briefly referred to the importance of optimally designing disclosure. The disclosures that I have in mind are not statistical disclosures; they are disclosures of individual-use information, so I am telling you what you actually did in the past two, three years.

Now you are still right that I could still try to tell myself that—let me back up for a second. In the average-use disclosures, you would say, well, the average consumer did that; I am going to be different, I am better. But even with individual-use disclosure, because it is disclosure of past behavior I could say, well, that was me in the past. Me in the future, I am going to be much better. But it will be harder for me to convince myself that I am better than my previous self, as compared to better than some average Joe. So you are right, there are limits to disclosure, but it is still better when you are doing individual-use information.

Judge Fletcher: Microphone 3 and then 1.

Mr. George H. T. Dudley (U.S. Virgin Islands): This has been a fascinating presentation. Thank you.

My question is, in this atmosphere of anti-regulation, I am wondering how much the communications industry is being helpful in providing you, on a voluntary basis, the information that is central to your work, or is it that you are waiting for the Dodd-Frank and other legislation to require them to provide this information?

Professor Bar-Gill: So the question of data is critical, and I did not have the time to talk enough about the data that we used in the cell-phone context. I do this in the relevant articles, but one of the main problems with these data is they are quite old. We need new data from cell-phone companies, from credit-card issuers.

Now they are not going to give these data to me. I tried. But they will give the data to the Federal Communications Commission, and they will give the data to the new Consumer Financial Protection Bureau. The CFPB has already conducted a research conference on the implications of the CARD Act, and they basically requested information from issuers on exactly how their practices have changed after the CARD Act, and now a new director of research has been appointed to the CFPB, one of the leading economists from Harvard. So I think there is room for optimism about the ability to get this data probably directly to the regulators, and I look forward to working with them on the data that they get.

Mr. Dudley: Are you telling me that you are not seeing any pushback from the industry on providing this information even to the regulators?

Professor Bar-Gill: We do see pushback, and just to give you an example, so what happened when the CFPB asked for this information from the card issuers, what they did was each one of the major issuers sent their data to a trustee, to a third party. They pooled all the data together and then presented information from the pooled data to the CFPB, so you couldn't trace it back to the practices of each individual issuer.

Now even that, for the purpose of the type of research that I am doing, is very useful. When the CFPB or the FCC will want to engage in more direct-enforcement actions, they will need direct information on what a specific seller, issuer, carrier has been doing, and now they have the authority to request this information.

Mr. Dudley: Thank you.

Judge Fletcher: Microphone 1.

Professor Herbert I. Lazerow (Cal.): Two questions, one factual, one normative. The factual question is, to the extent that the consumer changes plans, is there any guarantee that we don't have a situation where we are using static numbers in a dynamic situation? That is, the consumer who changes plans may well change his usage.

The normative question is, is there a significant difference between requiring the company to provide information and simply requiring the company to make available to the consumer the best possible plan after experience?

Professor Bar-Gill: Thank you very much.

Let me take these questions in turn. You are absolutely right, usage does change over time, and that's why I think it is important that we focus on these soft-paternalistic types of interventions. So if we had an idea, what is the best plan, given past usage of consumers, and we forced the consumer into that plan, then the problem that you mention is a very big one, but what I am suggesting is simply to provide consumers with information on their past usage. Now if I am a consumer and I know, well, so this is information on my past usage, but I now have a new job, I'm going to be traveling much more, so this historical information is less relevant to me, I will ignore it or I will give it less weight. If, on the other hand, I think, well, there's nothing, no big changes in my life, then I will give more weight to this historical information. Disclosure empowers consumers; it does not restrict their choices. This is one of its advantages.

Now to your second question. So why should we not just require the carriers or any other sellers of consumer products to just offer the best products? Again, my basic answer is that I want to give consumers the power to choose, so I think this is important both from an economic consequentialist approach, also from an autonomy approach, give them the information, tell them this is the plan that we think is best for you, given your usage, but don't hide from them other options.

Let me just give you some anecdotes here that are tangentially related to your question. I don't know, some of you may have experienced this. Consumers often get phone calls from their cell-phone carriers telling them, well, we actually figured out that given your usage, you should move to another plan that we can offer you. Now these phone calls are usually made just before your contract expires, when they want you to renew for another two-year commitment with them, so the basic idea is yes, we want them to recommend products based on usage but not to wait until the very end and not to foreclose other options. (*Applause*)

Judge Fletcher: Thank you, Professor Bar-Gill, for a wonderful lecture and wonderful responses to very interesting questions, and recognizing that he was likely to share with other consumers a bias toward the short term, I postponed giving him his plaque and check until now. (*Laughter*) (*Applause*)

Professor Bar-Gill: Thank you very much.

President Ramo: I should say that, in addition to my being thrilled to be here today—I think this is so important for the Institute, and the Institute is so important to the democracy—that we are really thrilled to have you both engaged, that in addition to the wonderful medal that we have presented and, as Judge Fletcher said, the small but we hope helpful check, in fact I was thinking about it as you were both talking, we gave you an actual check, maybe you've never seen an actual check. (*Laughter*) And I assume you will take your cell phone and deposit it somehow (*laughter*) or do something with it, I don't really know. What is very important to us is that there is a third part of this, of the award of this prize, and that is that we have given each of them an opportunity to organize a seminar on a topic of their choice, with participants of their choice, in the hope that something will come out of it that might be of potential work for The American Law Institute. This is a different way of our going about making our work important in today's world, and we are as excited about those seminars as we are about every other part of this award.

Let me, again, thank Judge Fletcher. I was thinking he was the perfect person in every way to lead us because, in a way, he is kind of the ideal of what we think of, of The American Law Institute. He is both a scholar and a judge—we don't always get both of those in the same package—and we are very grateful, Willie. Thank you very, very much. (*Applause*)