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Law of Bargaining: The Law of Bargaining

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THE LAW OF BARGAINING

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Negotiation is often compared to poker. This analogy is apt in two related respects. First, poker players and negotiators both sometimes perceive opportunities to deceive or exploit their counterparts in ways that produce a distributive advantage. Indeed, lies, bluffs, false signals, and manipulation occupy a significant place in the repertoires of some negotiators. Second, the ability of both negotiators and poker players to deceive and exploit is constrained by rules governing behavior. This brief essay surveys the ways in which law constrains such behavior on the part of negotiators.

At least three categories of rules comprise the law of bargaining. First, common law limitations govern virtually all negotiators: the doctrines of fraud and misrepresentation limit the extent to which negotiators may deceive, and the doctrine of duress limits the extent to which bargainers can use superior bargaining power to coerce agreement. Second, context-specific laws sometimes circumscribe negotiating behavior in specific settings when general rules are less restrictive. Third, the conduct of certain negotiators is constrained by professional or organizational regulations inapplicable to the general public. These categories are discussed in turn. The final section of this essay reflects on constraints on negotiator behavior in the absence of law.

I. COMMON LAW LIMITS ON BARGAINING BEHAVIOR

When a negotiated agreement results from false statements made during the bargaining process, the common law of tort and contract sometimes holds negotiators liable for damages or makes their resulting agreements subject to rescission.[1] The common law does not, however, amount to a blanket prohibition of all lying. Instead, the common law principles are subject to the caveats that false statements must be material, the opposing negotiator must rely on the false statements, and such reliance must be justified. Whether reliance is justified depends on the type of statement at issue and the

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1. *See generally* RESTATEMENT (SECOND) OF TORTS § 525 (1986); RESTATEMENT (SECOND) OF CONTRACTS § 164 (1982).

statement's specificity. A seller's specific false claim ("this car gets eighty miles per gallon gas mileage") is actionable, but his more general claim ("this car gets good gas mileage") is probably not, because the latter statement is acknowledged as the type of "puffing" or "sales talk" on which no reasonable buyer would rely.

While it is often said that misrepresentations of fact are actionable but misrepresentations of opinion are not, this statement is not strictly accurate. Statements of opinions can be false, either because the speaker does not actually have the claimed opinion ("I think this Hyundai is the best car built in the world today") or because the statement implies facts that are untrue ("I think this Hyundai gets the best gas mileage of any car"). But statements of opinion are less likely to induce justified reliance than are statements of specific facts, especially when they are very general, such as a claim that an item is one of "good quality."[2]

Whether reliance on a statement of fact or opinion is justified depends significantly on the context of the negotiation and whether the speaker has access to information that the recipient does not. A seller "aggressively" promoting his product whose stated opinions imply facts that are not true is less likely to find himself in legal difficulty if the veracity of his claims are easily investigated by an equally knowledgeable buyer than if his customer is a consumer unable to evaluate the factual basis of the claims.[3] The case for liability is stronger still when the negotiator holds himself out as being particularly knowledgeable about the subject matter that the expressed opinion concerns.[4] Whether a false statement can be insulated from liability by a subsequent disclaimer depends on the strength and clarity of the disclaimer, as well as on the nature of the false statement. Again, the standard is whether the reasonable recipient of the information in total would rely on the statement at issue when deciding whether to enter into an agreement.[5]

It is universally recognized that a negotiator's false statements concerning how valuable an agreement is to her or the maximum she is willing to give up or exchange in order to seal an agreement (the negotiator's "reservation point," or "bottom line") are not actionable, again on the ground that such false statements are common and no reasonable negotiator would rely upon

2. *See* Royal Bus. Machs., Inc. v. Lorraine Corp., 633 F.2d 34, 42 (7th Cir. 1980) (calling such statements "'puffing' to be expected in any sales transaction").

3. *See, e.g.*, Vulcan Metals Co. v. Simmons Mfg. Co., 248 F. 853 (2d Cir. 1918).

4. *See* Pacesetter Homes v. Brodkin, 85 Cal. Rptr. 39, 43 (Ct. App. 1970).

5. *See, e.g., In re* Trump, 7 F.3d 357, 369 (3d Cir. 1993) (finding that repeated warnings of risk meant that "no reasonable investor could believe anything but that the . . . bonds represented a rather risky, speculative investment," despite other optimistic claims about the financial stability of the issuer).

them. So an insurance adjuster who claimed that $900 was "all he could pay" to settle a claim is not liable for fraud, even if the statement was false.[6] The law is less settled regarding the status of false statements concerning the existence of outside alternatives for a negotiator. A false claim of an offer from a third party is relevant because it implies a strong reservation point, so a negotiator might logically argue that such a claim is no more actionable than a claim as to the reservation point itself. But courts have occasionally ruled that false claims of a specific outside offer are actionable, on the ground that they are material to the negotiation and that the speaker has access to information that cannot be easily verified by the listener's independent investigation.[7]

The most inscrutable area of the law of deception concerns when a negotiator may be held legally liable for failing to disclose information that might weaken his bargaining position (rather than affirmatively asserting a false claim). The traditional laissez-faire rule of caveat emptor eroded in the twentieth century, with courts placing greater disclosure responsibility on negotiators. It is clear that any affirmative action taken to conceal a fact, including the statement of a "half-truth" that implies a false fact, will be treated as if it were an affirmative false statement. Beyond this point, however, the law becomes murky. Although the general rule is probably still that negotiators have no general disclosure obligation, some courts require bargainers (especially sellers) to disclose known material facts not easily discovered by the other party.[8]

Just as the law places some limits on the use of deceptive behavior to seal a bargain, so too does it place some limits upon negotiators' ability to use superior bargaining power to coerce acquiescence with their demands. In general, negotiators may threaten to withhold their goods and services from those who will not agree to their terms. Courts can invoke the doctrine of duress, however, to protect parties who are the victims of a threat that is "improper" and have "no reasonable alternative" but to acquiesce to the other party's demand,[9] such as when one party procures an agreement through the threat of violence,[10] or through the threat to breach a prior agreement after

6. Morta v. Korea Ins. Corp., 840 F.2d 1452, 1456 (9th Cir. 1988).

7. *See, e.g.*, Kabatchnick v. Hanover-Elm Bldg. Corp., 103 N.E.2d 692 (Mass. 1952) (falsely claiming a "bona fide offer from one Melvin Levine . . . of $10,000 per year"); Beavers v. Lamplighters Realty, 556 P.2d 1328 (Okla. 1976) (falsely claiming a prospective buyer was willing to pay the asking price for a house and would be delivering a check that same day).

8. *See, e.g.*, Weintraub v. Krobatsch, 317 A.2d 68 (N.J. 1974) (sellers must disclose known insect infestation of house).

9. *See* RESTATEMENT (SECOND) OF CONTRACTS § 175(1) (1982).

10. *See, e.g.*, Rubenstein v. Rubenstein, 120 A.2d 11 (N.J. 1956); RESTATEMENT (SECOND) OF CONTRACTS § 176(1)(a) (1981).

using the relationship created by that agreement to place the victim in a position in which breach would cause noncompensable damage.[11] Judicial intervention is most likely when the bargaining parties' relationship was not arms-length. For example, the common law provides the defense of undue influence to negotiators who can show that they were dependent upon and thus vulnerable to the other, dominant negotiator.[12]

II. CONTEXT-SPECIFIC REGULATION OF NEGOTIATORS' BEHAVIOR

Beyond the general common law constraints on negotiators' behavior, the law imposes particularized parameters on bargainers engaged in negotiations in some specific contexts. For example, labor law places a number of procedural restrictions on negotiating behavior. Compared with their counterparts in non-unionized settings, employers, employees, and their representatives involved in collective bargaining all have considerable limits on their ability to adopt certain approaches to negotiating the terms and conditions of employment.

While federal and state laws proscribe a range of behaviors in collective bargaining contexts, the most vivid encapsulation of these requirements is the duty imposed on both sides by the National Labor Relations Act to bargain in "good faith."[13] The concept of "good faith" bargaining lacks clear parameters, but a "totality of conduct" standard[14] has given way to a list of proscribed behaviors, such as disengaging from the negotiations and presenting take-it-or-leave-it offers.[15]

In other contexts, the law imposes affirmative duties of disclosure rather than attempting to define the parameters of negotiation behavior. For example, in residential real estate transactions in many states, sellers have a legal obligation to disclose a range of information even if the buyer does not request it.[16] Supplanting the baseline principle of caveat emptor, many states have judged that real estate transactions require different foundational principles.

Finally, in certain bargaining contexts that seem unusually prone to exploitation, the law provides paternalistic protection for potential victims. For example, certain legal disputes involving seamen on the high seas and

11. *See, e.g.*, Austin Instruments, Inc. v. Loral Corp., 272 N.E.2d 533 (N.Y. 1971).

12. *See* RESTATEMENT (SECOND) OF CONTRACTS §177 (1979).

13. *See* 29 U.S.C. § 158(d) (2003).

14. NLRB v. Katz, 369 U.S. 736 (1962).

15. *Compare* NLRB v. Gen. Elec. Co., 418 F.2d 736 (2d Cir. 1969), *with* Logemann Bros., 298 NLRB 1018 (1990).

16. *See, e.g.*, WIS. STAT. § 709.02 (2001-2002).

their employers require judicial approval, because of the perceived power imbalance between seamen and ship owners.[17] Similarly, most jurisdictions require court ratification of divorce agreements.[18] To protect principal parties with little ability to monitor their agents, settlements of class action[19] and shareholder derivative suits[20] also require a judicial finding of fairness. Rather than judicial oversight, many jurisdictions give consumers in certain vulnerable contexts the self-help remedy of unilaterally rescinding an agreement within several days of acceptance, such as when they accept a bargain proposed by telemarketers or door-to-door salespersons.[21] Finally, the law sometimes establishes alternative dispute resolution mechanisms for contexts frequently characterized by dissatisfaction with negotiated agreements. For example, lemon laws anticipate that some percentage of negotiations over used car purchases will result in unhappy consumers. In states with lemon laws, consumers who are dissatisfied with their purchase need not establish one of the traditional bases for rescinding a contract or ceasing performance (for example fraud, duress, or material breach). Instead, consumers have a streamlined system for demonstrating eligibility for the laws' protections after the fact.[22]

III. PROFESSIONAL AND ORGANIZATIONAL CONSTRAINTS ON BARGAINING BEHAVIOR

Some negotiators operate not only within the legal constraints applicable to the general public, but also within the parameters of professional or organizational codes of conduct. These parameters can provide another layer of substantive constraints on negotiating behavior (in addition to those provided by generally applicable law), additional or enhanced enforcement mechanisms, or both.

As an example, attorneys are subject not only to generally applicable legal constraints on negotiating behavior but also to the administrative regulations of their state bar associations, which generally reflect the American Bar

17. *See* Castillo v. Spiliada Mar. Corp., 937 F.2d 240, 243 (5th Cir. 1991) ("[S]eamen have enjoyed a special status in our judicial system [because] they occupy a unique position. A seaman isolated on a ship on the high seas is often vulnerable to the exploitation of his employer.").

18. *See, e.g.*, Drawdy v. Drawdy, 268 S.E.2d 30 (S.C. 1980) ("[I]t is incumbent on the family court . . . to satisfy itself that the agreement is a fair contractual end of the parties' marital claims.").

19. *See, e.g.*, Mars Steel Corp. v. Cont'l Ill. Nat'l Bank, 834 F.2d 677 (7th Cir. 1987).

20. *See, e.g.*, United States v. City of Miami, 614 F.2d 1322, 1331 (5th Cir. 1980).

21. *See, e.g.*, HAW. REV. STAT. § 481p (2001) (option to cancel telemarketer-induced sales); 16 C.F.R. § 429.1 (2003) (cooling-off period for door-to-door sales).

22. *See, e.g.*, OR. REV. STAT. § 646.315-.375 (2001); OHIO REV. CODE ANN. § 1345.71-.78 (Anderson 2001).

Association's *Model Rules of Professional Conduct.* Model Rule 4.1(a) provides that "[i]n the course of representing a client a lawyer shall not knowingly . . . make a false statement of material fact or law to a third person."[23] The commentary to the rule suggests that the scope of the rule roughly parallels the common law. For example, estimates of "price or value" are not considered material,[24] thus permitting lawyers in general to "puff" as well as lie outright about their reservation prices. One important difference, however, between the administrative law governing lawyer-negotiators and the common law governing all bargainers is the absence of the requirements of reliance and damages in the regulatory context. To sustain a tort or contract action, the victim must actually suffer harm. Although punishment for transgressions in bargaining outside of the doors of the courthouse is a relatively rare occurrence, lawyers can face disciplinary action for making material misrepresentations even if no legally cognizable damage results.

IV. NEGOTIATIONS BEYOND LAW'S REACH

Not all negotiations take place in a context in which legal structures can constrain the behavior of negotiators. Some negotiations are conducted in such a private forum that law serves at most a minimal function. Spouses' negotiations about the division of household tasks, child rearing philosophies, and appropriate toilet seat protocols may take place largely beyond the reach of the law. The law has only minimal impact on other negotiations because of unlikely enforcement prospects. The black market thrives on the wings of vibrant negotiation, yet the law provides few behavioral boundaries in those negotiations. Similarly, the law of nations includes an expectation that parties will negotiate terms of treaties. No consistent, enforceable legal structure exists, however, to give force to any constraints on the negotiating behavior of those states. Finally, in some negotiations, the product of the bargain precludes any obvious remedies—even in cases when one of the parties exceeded expected boundaries of behavior. If two businesses deceive each other in crafting the terms of a joint venture, the law informs how the damage from their conduct may be remedied. If, however, two legislators deceive each other in negotiations over the terms of a new piece of legislation, no obvious bases for legal rescission or damages exist.

In these contexts, the threat of extra-legal penalties (in addition, of course, to personal ethical commitments) may constrain negotiators' behavior. For example, in many of the circumstances described above, an aggrieved negotiator may impose a reputational sanction on the transgressor by

23. MODEL RULES OF PROF'L CONDUCT R. 4.1(a) (2004).

24. *Id.* R. 4.1 cmt. 2.

revealing the allegedly inappropriate behavior. Many parties will behave differently in a bargaining session they believe to be entirely private than in negotiations that take place within the shadow of a threat to disclose. Although the prospect of publicity is different in structure from legal sanction, it nevertheless holds some promise of altering the negotiating behavior of those who are beyond the reach of the formal law of bargaining.

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