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The Right to Withdraw in Contract Law

Omri Ben-Shahar and Eric A. Posner¹

Abstract. European law gives consumers the right to withdraw from a range of contracts for goods and services; American law, with narrow exceptions, does not. Yet merchants in the United States frequently provide by contract that consumers have the right to return goods. We analyze the right to withdraw in a model that incorporates a tradeoff between allowing consumers to learn about goods that they purchase and protecting sellers from the depreciation of those goods. The right to withdraw—at least, as a default rule—has a plausible economic basis. We identify a nascent version of it in the well-known, controversial case of *ProCD v. Zeidenberg*.

A buyer orders a computer over the Internet. When it arrives, she discovers that the computer does not operate as quickly as she hoped, or that it does not look good on her desk, or that it has a more limited warranty than she remembered reading about on the website. She calls up the seller and demands that it take back the computer and return her money.

Many sellers would comply, but not all, and legally sellers usually have no obligation to take back conforming goods that do not satisfy buyers—unless they agreed to by contract. In the United States, there are few exceptions to this rule. A Federal Trade Commission regulation provides for a three-day cooling-off period for certain goods that are purchased away from the seller's permanent place of business, such as goods purchased at home from door-to-door salespeople.² Some states provide more generous treatment. For example, New York gives consumers the right to return unused and undamaged goods within 30 days unless the store conspicuously posts a different return policy.³ In Europe, mandatory rights of withdrawal exist for transactions that take place by phone or on the Internet, and other transactions that do not fully take place on the premises of the seller. Depending on the type of transaction, consumers may have as long as two weeks to return the goods for a refund. These rules apply to a range of transactions, including ordinary goods, services, and loans, and sellers cannot opt out of them.

European law in this way recognizes the consumer's "right to withdraw." There is no such generic right in the common law of contract or in the Uniform Commercial Code in the United States. We will argue, however, that the right to withdraw has a plausible efficiency rationale. In our model, the buyer does not know how much she values the good until she has had a chance to take it home and inspect or use it. By using it, she learns whether she has a high valuation or a low valuation. If the buyer has a low valuation, she does best by returning the good to the seller. However, the buyer also has an incentive to use the good excessively. To

¹ University of Chicago Law School. Thanks to Richard McAdams, Mike Schill, and participants at a workshop at the University of Chicago for helpful comments, and to Hanna Chung for research assistance.

² See FTC Door to Door Sales Cooling Off Rule, 16 C.F.R. § 429 (2008). Some state statutes provide similar protections for particular types of transactions, such as sales made by telemarketers. See, e.g., Ala. Code 1975, § 8-19A-14, which provides for a 14-day cancellation period.

³ N.Y. Gen. Bus. § 218-a; see also Cal. Civ. Code § 1723.

eliminate this incentive, the buyer must pay restitution equal to the depreciation of the good. With this incentive, the buyer will return the good only if she values it less than the seller does.

Our model suggests that American law is excessively strict but that European law is excessively generous. American law should recognize a generic right to withdraw, as European law does. However, the rule should be a default rule, not a mandatory rule, as it is in Europe. In addition, it is important that the seller have the right to restitution for depreciation costs—which is not as clearly recognized in European law as it should be.

In the second part of the paper, we hunt for traces of the right to withdraw in American law, and suggest that some courts have recognized an embryonic version of it. Notably, the holdings in *ProCD v. Zeidenberg* and *Hill v. Gateway*,⁴ two well-known cases that have long been criticized as excessively harsh toward consumers, reflect the policy concerns that underlie the right to withdraw. In these cases, buyers were held to have the right to withdraw from the transactions if they discover, after the purchase, that the goods came with undesirable legal terms. However, we argue that *ProCD* and *Gateway* do not address these policy concerns in a doctrinally satisfying way. The cases rely on offer and acceptance doctrine, which is poorly suited to the problem. And they suggest that the policy concerns are tied to the problem of hidden boilerplate terms in contracts, when the policy concerns apply more generally to all the characteristics of a product or service.

We are not aware of any prior law and economics scholarship on the right to withdraw. The literature on consumer protection law focuses on the typical American rules—such as disclosure requirements, rules governing advertising, and limits on certain types of contractual provisions such as cross-collateral clauses (e.g., Beales, et al. 1981). The problem of consumer information is addressed by securing the buyer an opportunity to learn information prior to sale, not after the sale (e.g., Craswell 1988). A large literature on the unconscionability doctrine and related judge-made rules that police contracts typically involving consumers also focuses on the disclosure of information to the buyer prior to sale (e.g., Craswell 1993).⁵

I. Background

The right to withdraw has its origins in the national legal systems of various European countries, but in recent years it has emerged as a prominent feature of European contract law (Loos 2009, 239). A series of directives issued between 1985 and 2008 introduced the right of withdrawal for life insurance, real estate timeshares, distance selling of goods and financial services, and consumer credit contracts. In 2008, the European Commission proposed a new Directive on Consumer Rights (“DCR”), which would subsume and extend some of the previous directives. Chapter III of the proposed DCR recognizes a general right to withdraw for most

⁴ *ProCD v. Zeidenberg*, 86 F.3d 1447 (7th Cir. 1996); *Hill v. Gateway* 2000, 105 F.3d 1147 (7th Cir. 1997).

⁵ We do not address possible justifications for consumer protection laws, including cooling off periods, that rely on cognitive biases (Camerer et al. 2003, pp. 1240-42; Hillman and Rachlinski 2002; Sunstein and Thaler 2003, pp. 1187-88).

distance and off-premises contracts.⁶ The right to withdraw also appears in the 2008 draft Common Frame of Reference for European Private Law (von Bar et al. 2008), an academic effort at codifying European private law, including contract law.

In all of these documents, the right of withdrawal simply provides the consumer the right to cancel the contract within a period of time after the contract has been entered. The consumer must return the goods or discontinue use of the services, and in return the seller must return the purchase price. Typically but not always, the consumer must pay the cost of depreciation, if any.

We will focus on the draft DCR. The right to withdraw applies to “distance contracts” (where the seller and consumer make the sale using a “distance communication” such as a telephone or the Internet) and “off-premises contracts” (where the seller and consumer conduct business in each other’s physical presence but away from the premises of the business).⁷ The seller has an obligation to inform the consumer of the right to withdraw at the time of contracting.⁸ The consumer has a fourteen-day period in which to exercise the right to withdraw. Withdrawal is entirely discretionary; the consumer need not have, or provide, a reason for withdrawing from the contract.⁹ After the consumer exercises the right to withdraw, the seller must return any payments received within thirty days.¹⁰

The consumer bears the cost of returning the goods unless the seller has agreed otherwise. The consumer is also liable for “any diminished value of the goods resulting from the handling other than what is necessary to ascertain the nature and functioning of the goods,” unless the trader did not give notice of the right to withdraw prior to contracting. Likewise, the consumer is not charged for any benefit he derived prior to withdrawal. Thus, in the case of service contracts, the consumer is not liable for the cost of performance prior to withdrawal.¹¹

There are numerous exceptions to the right of withdrawal. For distance contracts, examples include goods and services whose prices depend on fluctuations in financial markets, customized goods, sealed recordings and software that were unsealed by the consumer, newspapers and other periodicals, gaming and lottery services, and auction contracts.¹² For off-premises contracts, examples include food items sold by grocery stores that were ordered by the consumer and delivered to her home, emergency services, and certain repair and maintenance services performed on the consumer’s property.¹³ Other excluded contracts include sales involving real estate, conducted through vending machines, and of foods and beverages in restaurants, and certain credit, insurance, and financial services contracts.¹⁴

⁶ Proposal for a Directive of the European Parliament and of the Council on Consumer Rights, COM (2008) 614 final.

⁷ Directive on Consumer Rights, Art 2(6)-(8).

⁸ DCR, Art. 9(b).

⁹ DCR, Art. 12(1).

¹⁰ DCR, Arts. 16, 17(1).

¹¹ DCR, Art. 17.

¹² DCR, Art. 19(1).

¹³ DCR, Art. 19(2).

¹⁴ DCR, Art. 20.

The legalization of the right to withdraw serves a number of purposes. Loos (2009, 245–49) identifies four: protecting consumers from aggressive sales tactics; encouraging consumers to engage in long-distance purchases; encouraging consumers to use the Internet to make purchases; and enabling the consumer to understand complex contracts. As Loos notes, the second and third justifications are not persuasive, at least in the United States. If there ever was a psychological barrier against buying goods from someone outside one’s presence, it has by now surely crumbled. These justifications may reflect special European concerns, namely, the drive to integrate national markets.

The first and fourth motivations are plausible. There are longstanding concerns about aggressive doorstep sales tactics, telemarketing, and other occasions in which consumers are vulnerable to “seduction,” such as timeshares bought during holidays. In the United States, national regulations and state statutes regulate these transactions—often by mandating rights to withdraw during “cooling-off periods.” However, there is no counterpart in the United States for the right of withdrawal for complex contracts. Rather than giving consumers a right to withdraw, American law relies on mandated disclosures, requiring sellers only to alert consumers of onerous, unexpected terms by using conspicuous language in the contract. If the consumer is merely unhappy with the goods once she has had a chance to inspect or use them, she has no remedy (so long as the goods conform to the descriptions and warranties), unless the contract itself gives her the right to return the goods.

And, indeed, common experience teaches that nearly all retail stores in the United States permit customers to return merchandise for a refund.¹⁵ The details of store policy differ, of course. Customers might have just a few days to return goods or a very long time; they might be able to return the goods for cash or just for store credit; they might have to pay shipping or restocking fees, or might not. But the core right to withdraw, at least for stores selling new goods, seems virtually universal.

We examined the return policies of two major retail stores, Wal-Mart and Target. Wal-Mart has the largest share of the retail market in the United States, about 11 percent.¹⁶ Target has the sixth largest market share. Wal-Mart offers the same terms for goods sold in brick-and-mortar stores and goods sold over the Internet. Customers can return virtually all items for cash or credit. Apparel must be returned unworn, with tickets attached. Music, movies, and software must be unopened. Books must be unused and unmarked. Autographed memorabilia must include the certificate of authenticity. Some products may only be returned to a physical store because of shipping regulations (for examples, products with flammable liquids, tires). Other products may only be returned by special shipping arrangements (for example, caskets, jewelry over \$300, oversize items). And so on. The return period is 90 days, except for certain items (computer components—45 days, cameras—30 days, cell phones—15 days). Customers without receipts have 45 days to return goods and can return no more than three orders in that period.

¹⁵ As is also the case with service providers, which often provide a menu of options, allowing consumers to purchase a high-price service with a free option to withdraw, or a low-price service with no option or a costly option to withdraw (for example, airline tickets). See Scott & Triantis 2004.

¹⁶ See <http://money.cnn.com/2009/06/05/news/companies/wal-mart.shareholders.meeting.fortune/>.

Wal-Mart appears to absorb the shipping fee if the product is returned by carrier, with some exceptions (for example, furniture).¹⁷

Target has a similar policy. It permits nearly all items to be returned within 90 days, regardless of whether they are purchased from a store or over the Internet. Refunds have the same form as the payment: if the buyer used cash, the refund is in cash; if the buyer used credit, the refund is in credit. Unlike Wal-Mart, Target charges a restocking fee of 15 percent for certain portable electronics, and does not cover the cost of shipping the returned good unless the return was the result of Target's fault.¹⁸

II. The Theoretical Basis of the Right to Withdraw

A. Summary of Model

A buyer and seller enter a contract involving the sale of a good. At the time of contracting, the buyer is uncertain about how much he values the good. Consider a piece of furniture such as an office chair. The buyer can evaluate the quality at the store but does not know how it will look and work in his house. After delivery, the buyer sees how the chair looks in his study and in this way gains information about how much he values the good. This information improves with the passage of time; for example, the buyer needs to actually use the chair to learn if it is comfortable. The chair, however, depreciates with the passage of time.¹⁹

The optimal contract would balance the buyer's gain from the reduction of uncertainty, and the seller's loss in terms of depreciation. If the buyer gains a great deal of information from having the good in his house, and the good depreciates very little, the buyer would have the right to return the good. This right benefits the seller *ex ante*, because buyers are more likely to buy a good if they have the right to return it if they do not like it. At some point depreciation costs will exceed the information benefits; at this point, the right to free withdrawal should end.

Another version of the optimal contract would give the buyer, rather than a free withdrawal right, the option to return the good and pay the depreciation loss to the seller. This contract forces the buyer to internalize the cost that the decision to withdraw imposes on the seller, and in this way gives the buyer the socially optimal incentive to keep or return the good. As long as the depreciation is priced accurately, this contract does not require an *ex ante* prediction of the point in time at which depreciation costs will exceed the information benefits.

Both of these contracts, however, may be impractical because they rely on accurate pricing of depreciation, either by the parties *ex ante* or by courts *ex post*. A third approach, one which overcomes this information problem, is to use time as a proxy for depreciation. If goods tend to depreciate slowly, while buyers can gain most of the information they need quickly, then the optimal right of withdrawal would extend for just a few days after the sale.

¹⁷ See <http://www.walmart.com/cp/Returns-Policy/538459>.

¹⁸ See <http://www.target.com/Return-Refund-Policy-Returns-Refunds/b?ie=UTF8&node=13685491>.

¹⁹ For expository simplicity, we use the term "depreciation cost" to encompass all costs incurred by the seller as a result of the transfer of the good to the buyer, including opportunity cost (the seller cannot sell the good to another person), destruction of intellectual property (the buyer records the product and returns it), and so on.

The model demonstrates that rules that mandate free withdrawal for a fixed period can lead to inefficient outcomes any time the depreciation cost exceeds the allocative value that more information affords the buyer. The longer the free withdrawal period, the greater the potential inefficiency. Further, the depreciation costs sellers expect to suffer as a result of free withdrawals translate into higher prices. This, in turn, leads to another source of inefficiency: some efficient transactions are not entered into, ex ante.

B. Framework of Analysis

Two parties, a buyer and a seller, are contracting over the sale of one indivisible good. The value of the good to the buyer is uncertain at the time of the contract and will be revealed over time. We assume a very simple information structure, as follows.

- $t = 0$: the time of the contract – it is known that the value of the good will be either High or Low, denoted v_H and v_L , with respective probabilities q and $1-q$.
- $t = 1$: the signal – the buyer receives a signal s regarding the value of the good:
 - If the true quality of the good is v_H , the signal will be $s = v_H$
 - If the true quality of the good is v_L , the signal will be:
 - $s = v_H$ with probability θ
 - $s = v_L$ with probability $1-\theta$.

Namely, it is assumed that at $t=1$, high quality is not likely to appear low, but low quality might appear high. There are only false positives, not false negatives—perhaps because the false negatives are not purchased in the first place (products are bought only if they appear High quality), and it takes time to identify the false positives.²⁰

- $t = 2$: full information – the buyer—if he didn't already know that the product was Low quality—receives additional information and can perfectly assess the quality of the good.

The seller's cost of performing the contract is c . We will interpret c to be the value that the seller can derive from the good outside the contract. It is assumed that $v_L < c < v_H$, namely, trade is efficient ex-post only if $v = v_H$.

It is assumed that at $t=1$ and $t=2$ the buyer can “withdraw” from the contract—return the good to the seller. If the good is returned, the buyer gets 0 value (that is, there is no interim benefit that the buyer gets prior to return). However, the good may depreciate over time. Let d_t denote the total depreciation at $t=1, 2$, and assume that $0 < d_1 < d_2$.

The contract between the parties sets a price P , to be paid by the buyer only if the good is not returned, and return fees R_1 and R_2 , to be paid by the buyer if the good is returned at $t=1, 2$, respectively.

²⁰ Thus, if the buyer receives a signal v_H , he can infer a probability $\frac{q}{q + \theta(1-q)}$ that the good is High quality, and a probability $\frac{\theta(1-q)}{q + \theta(1-q)}$ that the good is Low quality. If, instead, the buyer receives a signal of v_L , he can infer with probability $\frac{1-q}{1-q + (1-\theta)q}$ that the good is Low quality.

Finally, we assume risk neutrality, a zero discount rate, and symmetric information.

C. The Optimal Contract

The optimal contract needs to provide efficient incentives to withdraw at $t=1$ and $t=2$, and efficient incentive to trade at $t=0$. Since the optimal actions at early periods depend on what would optimally happen at later periods, we characterize the “second best” outcome (the best decisions that parties with incomplete information can make) by backward induction. With that, we’ll be able to identify the terms of the contract that induce optimal actions.

1. Efficient Withdrawal at $t=2$

The buyer should withdraw if the good’s value to the seller, after depreciation, exceeds the value to the buyer, which is assumed to be perfectly known to the buyer at $t=2$. That is, the buyer should withdraw if and only if

$$v < c - d_2.$$

If the good is known to be v_H , this condition cannot hold, because we assume that $v_H > c$, which means that it $v_H > c - d_2$. Intuitively, if it were efficient to withdraw even when the value of the good is High, it could never be efficient to purchase the good in the first place—withdrawal would be certain and the purchase would create depreciation without creating any value. Thus, conditional on the good having been purchased, the only situation in which it might be efficient to withdraw is when the quality is known to be v_L . Then, the buyer should withdraw if and only if $v_L < v^{**}$, where $v^{**} \equiv c - d_2$ is the minimum value of v_L , below which it would be efficient to withdraw at $t=2$.

2. Efficient Withdrawal at $t=1$

At $t=1$, the buyer may not know with certainty the quality of the good, and thus, in deciding whether to withdraw the buyer should evaluate the information signal he received and the “option value” embedded in holding on to the good and exercising withdrawal later.

If the buyer receives a signal $s = v_H$, the buyer knows that it is still possible that the good would be Low quality (since we assume that this signal is not conclusive—that at $t=1$ the Low quality indicators may not yet surface). However, if it were efficient for the buyer to purchase the good at $t=0$, it could never be efficient for the buyer to withdraw at $t=1$ when the signal is $s = v_H$. Otherwise, withdrawal would be certain and the purchase would create depreciation without creating any value.

If the buyer receives a signal $s = v_L$, the buyer should withdraw if $v_L < v^*$, where $v^* \equiv c - d_1$ is the minimum value of v_L , below which it would be efficient to withdraw at $t=1$.

Note that $v^* > v^{**}$,²¹ which means that we have three effective zones of v_L : (1) “Anytime Returns” ($v_L < v^{**}$): here, the buyer should withdraw at $t=1$ if the signal is $s = v_L$, or at $t=2$, if the good is then known to be v_L . (2) “Immediate Returns only” ($v^{**} \leq v_L < v^*$): here the buyer

²¹ $v^* - v^{**} = c - d_1 - (c - d_2) = d_2 - d_1 > 0$.

should withdraw only at $t=1$, if the signal is $s = v_L$; at $t=2$ the buyer should not withdraw even if the good is then known to be of low quality, because depreciation by then is too costly. (3) “No Returns” ($v_L > v^*$): here the buyer should not withdraw at any time even if he knows the good to be low quality.

3. Efficient Trade at $t=0$

Whether the buyer should purchase the good at $t=0$ depends on what is expected to happen at the ensuing periods—whether or not the good will be returned.

Region I: “Anytime” Returns: If it is efficient to withdraw at both periods, as soon as the buyer learns that the good is Low quality, trade should occur if and only if:

$$q \times v_H + (1 - q)[(1 - \theta)(c - d_1) + \theta(c - d_2)] \geq c$$

On the left hand side, if trade occurs there is a probability q that the good will be high quality and kept; and there is a probability $(1 - q)$ that the good will be low quality and returned, with the return occurring either at $t=1$ (if the signal at $t=1$ is v_L , which happens with probability $1 - \theta$), or at $t=2$ (if the signal at $t=1$ is v_H , which happens with probability θ). When the good is returned at time t , the social value of it is $c - d_t$. On the right hand side, if trade does not occur the value of the good in the hands of the seller is c . Thus, in this region, net welfare from trade is greater than from no-trade if:

$$c < v_H - \frac{(1-q)}{q}[(1-\theta)(d_1) + \theta d_2]$$

Region II: “Immediate” Returns Only: If it is efficient to withdraw only if the buyer learns of Low quality at $t=1$, but not at $t=2$, trade should occur if and only if:

$$q \times v_H + (1 - q)[(1 - \theta)(c - d_1) + \theta v_L] > c$$

Here, if the good turns out to be low quality it is either returned (at $t=1$, with probability $1 - \theta$), or kept by the buyer (with probability θ). Thus, in this region, net welfare from trade is greater than 0 if:

$$c < \frac{qv_H + (1-q)[(1-\theta)(-d_1) + \theta v_L]}{q + (1-q)\theta}$$

Region III: No Returns: When $v_L > v^*$, it is never efficient to withdraw because the depreciation—as early as at $t=1$ —makes the allocation of the good to the buyer efficient even if his value is v_L . Expecting that the good will not be returned, the buyer should purchase it if and only iff:

$$c < q \times v_H + (1 - q)v_L.$$

4. The Optimal Contract terms

Proposition 1: Optimal purchase and withdrawal would occur if:

$$P = c$$

$$R_1 = d_1$$

$$R_2 = d_2.$$

Proof. At $t=2$, the buyer will withdraw if $v_L - P < R_2$. Setting $R_2 = d_2$ and $P = c$ guarantees that the buyer will withdraw if and only $v_L < c - d_2$, the socially efficient outcome. At $t=1$, if the signal is v_H , the buyer will not want to withdraw, even though the good may still turn out to be v_L . If the buyer withdraws, his payoff is $-R_1$. Ex ante, his payoff negative, because the other contingency, in which the signal is v_L , is also a negative payoff. The buyer can do better by not entering the contract at $t=0$, thereby securing a payoff of 0. If, instead, the signal at $t=1$ is v_L , the buyer will withdraw if $v_L - P < R_1$. Setting $R_1 = d_1$ and $P = c$ guarantees that the buyer will withdraw if and only $v_L < c - d_1$, the socially efficient outcome.

Looking now at the buyer's incentives to trade, if $v_L < v^{**}$ the buyer will trade iff:

$$q \times (v_H - P) + (1 - q)[(1 - \theta)(-R_1) + \theta(-R_2)] \geq 0$$

Setting $R_1 = d_1$, $R_2 = d_2$ and $P = c$, this condition is equivalent to the socially optimal condition. If, instead $v^* > v_L \geq v^{**}$, the buyer will trade iff

$$q \times (v_H - P) + (1 - q)[(1 - \theta)(-R_1) + \theta(v_L - P)] > 0$$

Setting $R_1 = d_1$, $R_2 = d_2$ and $P = c$, this condition is again equivalent to the socially optimal condition. Finally, if $v_L \geq v^*$, it is never efficient to withdraw and the buyer will trade iff:

$$q \times (v_H - P) + (1 - q)(v_L - P) \geq 0.$$

Setting $R_1 = d_1$, $R_2 = d_2$ and $P = c$, this condition is again equivalent to the socially optimal condition. QED

Remarks. (i) *Intuition.* The optimal contract terms cause the buyer to internalize the external cost of the decision to withdraw. That external cost is the depreciation loss. Because the buyer must pay that cost under the terms of the optimal contract, he will withdraw from the contract if and only if the joint benefits exceed the joint costs. Since there is no deadweight loss in the decision to withdraw, there is also no inefficiency in the decision to trade.

(ii) *Optimal withdrawal policy.* There are other contract terms that achieve the optimal result. For example, a contract that stipulates free withdrawals any time the cost of depreciation, d_t , satisfies $d_t < c - v_L$, and no withdrawals otherwise, would not distort the withdrawal decision. The benefit to the buyer of free withdrawal would be offset by a higher price, but not too high to block efficient trade. In contrast to the optimal contract described above, in which the return fee is defined ex ante in the contract, here the right to withdraw needs to be determined ex post. Which version of the optimal contract is superior depends on the availability of information.

D. Analysis of Legal Regimes

We now examine the withdrawal and purchase decision under alternative legal rules that regulate the return fee paid by the buyer upon withdrawal. We compare the effects of each rule to the optimal contract—the one that would be negotiated by unconstrained parties to maximize the total gain from the transaction.

1. Free Withdrawal at $t=1$ and $t=2$

Suppose the law mandates the return fee at both periods to be zero: $R_1 = 0$, $R_2 = 0$. Let us examine the effect on the withdrawal decision, the price of the contract, and the decision to enter the transaction.

Since the buyer can return the good at no cost, the first thing to note, unambiguously, is that the buyer will withdraw from the contract as soon as he finds out for certain that $v = v_L$. By withdrawing, the buyer secures a payoff of 0. If he were to keep the good, the buyer's payoff would be $v_L - P$. Since we assume that the $v_L < c$, and since it must be that $P \geq c$, or else the seller would not enter the transaction (indeed, we will show below that $P > c$), we can be certain that $v_L - c < 0$, and the buyer would withdraw.

Ex ante, expecting withdrawal with probability q (the odds that the good is v_L), the parties' expected payoffs would be:

$$\begin{aligned} \text{Seller's payoff:} & \quad q(P - c) + (1 - q)[(1 - \theta)(-d_1) + \theta(-d_2)]. \\ \text{Buyer's payoff:} & \quad q(v_H - P). \end{aligned}$$

A transaction that guarantees non-negative expected payoffs to both parties would occur if and only if:

$$c + \frac{(1-q)}{q}((1-\theta)d_1 + \theta d_2) < v_H.$$

On the left hand side is the minimum price the seller will demand. On the right hand side is the maximum price the buyer will be willing to pay.

There are several things to note. First, if $v_L > v^{**}$, namely, in the region in which withdrawals are not always efficient, there is a distortion. We prove in the appendix that there are some transactions that are efficient but will not be entered into. These are cases in which there is social surplus from the transaction but the parties would nevertheless fail to realize it because the minimum price charged by the seller, which takes into account the burden of (inefficient) withdrawals—would exceed the maximal price the buyer would willing to pay. The effect of this inefficiency is the shrinking of the market. (We can, for example, assume that v_H is stochastic – that some buyers have higher v_H parameter than others; then, the effect of free withdrawals is to push out some but not all buyers.)

The reason for the distortion is that the loss at the v_L -contingency is not minimized. Socially, it would be better for the buyer to keep the good even though its value is low, rather than impose the cost of depreciation; but privately the buyer would prefer ex-post to exercise the right to free withdrawal. Further, as a result of the price increase that the seller charges to offset the costly withdrawals, the buyer is not made better off from the right to free withdrawal, and is in fact made strictly worse off. The buyer pays more, upfront, for the expected depreciation his withdrawals might impose on the seller than the cost he would have had to bear by keeping the good ex-post, when it is v_L . Essentially, the buyer is forced to purchase insurance against low

quality and the “premium” is costlier than the “coverage.” Thus, there is a deadweight loss without any redistributive effect.

Second, the distortion is greater the higher is v_L . It is useful here to distinguish between the two regions of $v_L > v^{**}$ that were characterized above, “Region II” in which it is inefficient to return the good only at $t=2$ (when $v^{**} < v_L \leq v^*$), and “Region III” in which it is inefficient to return the good also at $t=1$ (when $v_L > v^*$). The distortion in Region III is greater than in Region II. Formally, in Region II the expected loss of surplus is measured by

$$\frac{(1-q)\theta}{q}(v_L - (c - d_2)),$$

which has an intuitive interpretation: the loss of surplus occurs with probability $(1-q)\theta$, (that is, the likelihood of quality being v_L discovered only at $t=2$), and the magnitude of the loss is the difference between the efficient outcome, v_L , and the distorted outcome, $c - d_2$. (This expected loss is multiplied by $1/q$ because the upside from the transaction, v_H , occurs only with probability q .) By contrast, in Region III the expected loss of surplus is measure by

$$\frac{(1-q)}{q} [v_L - ((1-\theta)(c - d_1) + \theta(c - d_2))],$$

which, too, has an intuitive interpretation: the loss of surplus occurs with probability $1-q$, (that is, the likelihood of quality being v_L), and the magnitude of the loss is the difference between the efficient outcome v_L and the distorted outcome—either $c - d_1$ or $c - d_2$, with probabilities $(1-\theta)$ and θ , respectively. The expected loss of surplus is greater in Region III than in region II,²² because in Region III there is an additional distortion from withdrawals at $t=1$.

Lastly, if $v_L \leq v^{**}$, namely, in the region in which withdrawals are efficient both at $t=1$ and $t=2$, there is no distortion.²³ Although the buyer does not pay any return fee and does not internalize the cost he is inflicting on the seller, the buyer’s decision to withdraw is nevertheless efficient. In terms of distribution of surplus, the seller—anticipating the cost of depreciation that he would have to absorb—charges for it through the ex ante contract price, undoing any redistributive effect of the free-withdrawals policy.

2. Free Withdrawal at $t=1$ only

Suppose now that the law mandates the withdrawal fee to be zero only at $t=1$. That is $R_1 = 0$ but R_2 can be set at any level by the parties. Let us examine the effect of this more limited free-withdrawal right on the withdrawal decision, the price of the contract, and the decision to enter the transaction.

²² The expected loss of surplus is greater in Region III than in Region II by

$$\frac{(1-q)(1-\theta)}{q}(v_L - (c - d_1))$$

which is the added distortion from inefficient returns at $t=0$.

²³ That there is no distortion can be shown by comparing the condition for the occurrence of a transaction here with the socially optimal condition. They are identical.

At $t=1$, if the buyer learns that $v = v_L$, he will withdraw from the contract. At $t=2$, the buyer will withdraw if and only if $v_L < P - R_2$. Let us first examine the situation in which $v_L \geq P - R_2$, namely, the buyer does not withdraw at $t=2$. Ex ante, with the possibility of free withdrawal at $t=1$ but no withdrawal at $t=2$, the parties' expected payoffs would be:

$$\begin{aligned} \text{Seller's payoff:} & \quad q(P - c) + (1 - q)[(1 - \theta)(-d_1) + \theta(P - c)]. \\ \text{Buyer's payoff:} & \quad q(v_H - P) + (1 - q)\theta(v_L - P) \end{aligned}$$

A transaction that guarantees non-negative expected payoffs to both parties would occur if and only if:

$$c + \frac{(1 - q)(1 - \theta)d_1}{q + (1 - q)\theta} < \frac{qv_H + (1 - q)\theta v_L}{q + (1 - q)\theta}$$

On the left hand side is the minimum price that the seller would demand; on the right hand side is the maximum price that the buyer would be willing to pay. A positive surplus would exist if and only if:

$$c < \frac{qv_H + (1 - q)[(1 - \theta)(-d_1) + \theta v_L]}{q + (1 - q)\theta}$$

There are several things worth noting. First, this condition is identical to the social optimum condition in what we denoted above as “Region II”—the region in which $v^* \geq v_L > v^{**}$ and where it is efficient to withdraw only at $t=1$. Here there is no distortion, as long as $R_2 \geq d_2$ and P is set within the bargaining range, when such a range exists. For example, if the buyer has all the bargaining power, $P = c$ would be the price set and would lead to an efficient purchase decision.

Second, this condition identifies a distortion in “Region III”—the region in which $v_L > v^*$ and where it is inefficient to withdraw even at $t=1$. The inefficiency here is twofold: first, the buyer might withdraw at $t=1$ even though he should not. Second, the purchase price set by the seller would have to account for the inefficient cost of depreciation imposed on him by time-1 withdrawals, which would lead to a loss of some efficient transactions.²⁴

Third, the seller demands a price that is higher than cost because of the free time-1 returns. The price increase is greater the higher is d_1 (because the inefficient return is more burdensome), the lower is θ (because it is more likely that the time-1 signal will be v_L which would lead to an inefficient withdrawal), and the lower is q (because it is more likely that quality is v_L and a withdrawal would occur.)

We now turn to the possibility that $v_L < P - R_2$, namely, the buyer prefers to withdraw at $t=2$ and pay R_2 . Ex ante, with the possibility of free withdrawal at $t=1$ and paid-for withdrawal at $t=2$, the parties' expected payoffs would be:

²⁴ The distortion at Region III can be demonstrated formally as follows. The maximal feasible social welfare is $qv_H + (1 - q)v_L - c$. The actual combined welfare of the parties, given time-1 withdrawal, is $q(v_H - c) + (1 - q)(1 - \theta)[(v_L - (c - d_1))]$. Since in this region $v_L > (c - d_1)$, the actual welfare is less than the maximal feasible social welfare.

$$\begin{aligned}\text{Seller's payoff:} & \quad q(P - c) + (1 - q)[(1 - \theta)(-d_1) + \theta(R_2 - d_2)], \\ \text{Buyer's payoff:} & \quad q(v_H - P) + (1 - q)\theta(-R_2)\end{aligned}$$

A transaction that guarantees non-negative expected payoffs to both parties would occur if and only if:

$$c + \frac{(1-q)}{q}((1-\theta)d_1 + \theta(d_2 - R_2)) < v_H - \frac{(1-q)}{q}\theta R_2$$

On the left hand side is the minimum price that the seller would demand; on the right hand side is the maximum price that the buyer would be willing to pay. The condition can be simplified:

$$qc + (1-q)((1-\theta)d_1 + \theta d_2) < qv_H$$

There are several things worth noting. First, here, there is no inefficiency. This condition for the occurrence of the transaction is identical to the socially optimal purchase decision. Namely, the left hand side is the social cost of the transaction; the right hand side is the social benefit. The reason for the efficiency of the outcome is that there is no distortion at $t=1$ despite the free withdrawal, because it is efficient to return the good at this time; and there is no distortion at $t=2$ despite the costly return fee, because the return fee would not deter withdrawals.

Second, the seller demands a price that is lower than that under the two-period free returns regime. The buyer is willing to pay a price that is lower than his full valuation v_H , because he expects that he might have to bear the return fee at $t=2$. The reduction in the seller's asking price is exactly equal to the reduction in the buyer's offering price. This is a more efficient outcome than under the two-period free returns.

E. Extensions

Learning versus insurance. We assume that buyers learn about their valuation of a product over time, and that the right to withdraw allows them to take advantage of this additional information. The right to withdraw can have value for other reasons as well. Suppose, for example, that after the buyer enters the contract he loses his job and hence his desire to have an expensive good that he just purchased. In this case, the right to withdraw effectively gives the buyer insurance against adverse events that cause his valuation to decline (cf. Scott and Triantis 2004).

Insurance may therefore provide an additional justification for a right to withdraw (for risk-averse buyers). Indeed, many service providers such as airlines offer a menu of contracts. Consumers can purchase an expensive ticket with a free right to withdraw, or a cheap ticket with a costly right to withdraw or none at all. However, we suspect that insurance provides a limited justification for the right to withdraw. The events that lead to the decline of valuation could occur any time after the purchase, and are not concentrated in the initial period. Thus, the prevalence of short term rights to withdraw cannot be explained by the insurance aspect. The reason probably is that buyers prefer to self-insure, and keep the prices of products lower. Also, buyers are in a better position than the seller to estimate the probability of future adverse events and can purchase insurance from a third party.

Learning versus use. As noted earlier, a withdrawal right confers on the buyer the right to use a good for free as long as the good does not depreciate (or if, legally or practically, the buyer does not have to pay for depreciation). This creates a potential inefficiency, for it permits buyers to enter contracts for the temporary “use value” of goods where the buyer values that use value less than the cost to the seller. This is an important reason to require the buyer to pay for depreciation costs or to limit the duration of the right to withdraw. Or, if the population of such temporary “buyers” is large enough, it would be optimal to suspend the right to withdraw altogether.

Asymmetric information. We assume that sellers are uniform but in fact some sellers offer higher-quality products and services than other sellers do. In such a case, high-quality sellers (that is, sellers of higher-quality products) may use a right to withdraw as a signal of quality, just as sellers use warranties (indeed, the right to withdraw is just a type of warranty). As is familiar, signaling equilibria can be inefficient, justifying mandatory rules (Aghion and Hermalin 1990). However, the policy implications are ambiguous. Depending on the circumstances, mandatory rules that require or even ban the right to withdraw may improve social welfare.

Asymmetric information can go in the other direction. Suppose that buyers have private information about their propensity to withdraw. Stores that offer a right to withdraw will disproportionately attract buyers with a propensity to withdraw, and will have to charge higher prices, driving buyers without a propensity to withdraw to stores that do not offer a right to withdraw.

Secondary markets. The right to withdraw loses some of its value when secondary markets exist. If disappointed consumers can turn around and resell goods on eBay, they do not benefit from a right to return them to the original seller, aside from the shipping and other transaction costs. Rules that make goods more tradable in secondary markets, such as assignable warranties, reduce the value of the right to withdraw.

F. Normative Implications

Our model has implications for the optimal scope for the right to withdraw. In a world of perfect enforcement—where courts could perfectly determinate depreciation costs—the optimal legal regime would grant the buyer a right to withdraw on condition that he pay the seller restitution damages equal to the depreciation cost. In the real world, it may well be difficult for courts to measure depreciation. To avoid this difficulty, the law can use *time* as a proxy for *depreciation*. If depreciation occurs slowly, let the buyer have a free right to withdraw for an initial period; after that period, prohibit the buyer from withdrawing from the contract. The approaches can be combined, as well. For example, in the first period let the buyer withdraw; buyer must pay damages only if the seller can prove the depreciation loss. In the second period, prohibit withdrawal unless the buyer can prove that depreciation is zero.

One can also reserve the right to withdraw for certain types of transactions—those for which it is most likely to be valuable—and ban it for others. The right to withdraw is most likely to be desirable under two conditions.

The first condition is met when goods or services involved are difficult for buyers to evaluate, or the optimal terms of the contract are difficult to read and understand. Goods and services can be difficult to evaluate for a number of reasons. The value of some goods depends on how they look in the buyer's home (for example, furniture), how they look with other items the buyer owns and keeps at home (for example, clothes), and how they function with other items the buyer owns (for example, electronic components). In these cases, buyers cannot evaluate the goods without taking them home. In the case of other goods, the buyer may have trouble evaluating them without using them over an extended period of days (for example, musical equipment).

Another set of problems arises because of the complexity of the terms of a contract. Consider life insurance contract, credit contracts such as mortgages, and real-estate timeshare contracts—for all of which European law mandates a right to withdraw. Although in theory the buyer can read and understand the terms of these contracts at the time of contracting, in practice many buyers have trouble understanding complex terms. Extra time gives them the opportunity to ponder the contract and seek advice.

The second condition for the desirability of the right to withdraw is met when the goods do not depreciate or their depreciation can be easily measured. In the case of services, the right of withdrawal is likely to be desirable as long as it can be exercised only before the cost of providing the service is incurred by the seller or only a small fraction of that cost has been incurred.

Some goods depreciate rapidly when they leave the store: automobiles are one example, apparently because of the lemons problem. Other examples include food items and drugs that are removed from their packaging and can be contaminated. Musical recordings, software, databases, DVDs of movies, and other items that contain intellectually property that can be cheaply copied also belong to this category. For this reason, sellers seal them in packaging and permit return only if the packaging has not been broken—a practice that is validated in European law.

Many goods depreciate only if they are “used.” There is a delicate line here: stores expect consumers to try on clothes and return them if the clothes do not fit or don't suit the buyer's taste, but not to wear a tuxedo or fancy dress for an evening and then return it. Wal-Mart addresses this problem by permitting the return only if labels are attached: presumably, one does not mind trying on clothes with labels on them in the privacy of one's home but one would not want to go to a party wearing such clothes unless the label can be concealed. European law gives the seller a restitution remedy if items are used. The problem here is that the depreciation of clothes worn to a single party is probably close to zero, which means that a lawsuit would not be cost-justified, and, in effect, people could rent out clothes for free until they were reduced to threads. Stores probably protect themselves by ensuring that buyers bear some of the cost of return—an issue to which we will return shortly.

Wal-Mart forbids the return of caskets and urns. No doubt taboos are at work here. No one would want to buy a used casket, no matter how thoroughly it has been cleaned. Restrictions

on the return of undergarments (unless still in their sealed package) probably have a similar rationale.

Finally, certain transactions involve goods or other things whose value fluctuates rapidly. These include financial instruments such as stocks, commodities futures, and the like. Obviously, the right to withdraw would defeat the purpose of these contracts. A similar point can be made about auctions. European law does not grant a right to withdraw in these cases.

We suspect that, in practice, the seller's right to recover depreciation costs—in European law, and in some American states—has little value. In most cases, depreciation will be less than the cost of litigation; in addition, in many if not most cases, depreciation will be impossible to estimate. If buyers do not have to pay depreciation costs, they will have a strong incentive to engage in excessive use and inspection of goods—for the simple reason that the costs are externalized on the seller.

In the United States, sellers limit this strategic incentive by allocating some of the risk of disappointment to the buyer. In some cases, they exploit natural barriers. If the buyer must transport the goods back to the store, then he bears some of the cost of return, and accordingly will be deterred from excessive use and inspection of goods at the margin. In the case of distance contracts, sellers can produce the same effect by requiring the buyer to bear the cost of shipping the goods. Sellers also transfer some of the cost to buyers by charging restocking fees. European law permits sellers to charge the buyer for transportation costs, but does not appear to allow sellers to charge restocking or other fees.

This suggests that the optimal legal regime might give the buyer the right to withdraw for an initial period but also require the buyer to pay a small amount of money if depreciation cannot be calculated. Shipping costs (if any) or a low fee (say, 10 percent) may be justified. Such fees would, like deductibles in insurance policies, reduce the incentive to engage in strategic behavior.

III. Implications for American Law

As we noted earlier, the common law of contract in the United States does not recognize a right to withdraw. However, there are several related doctrines, in the common law and in statutes, suggesting that judges and legislators have recognized the problems that the right to withdraw addresses.

Extended right to reject offers. Offer and acceptance doctrines of contract law are typically understood to require an exchange of assent prior to the delivery of goods to the buyer. But they need not. In *ProCD v. Zeidenberg*, a buyer purchased a CD-ROM containing a database, which came along with license terms that restricted the buyer to noncommercial use of the database. These license terms were “shrinkwrapped”—they were packaged inside the box with the CD-ROM, and thus were not available for the buyer to examine prior to the sale. When the buyer attempted to make commercial use of the database by selling access to it, the seller sued, arguing that the buyer had breached the license. The buyer responded that the

noncommercial use restriction was not valid because it was not disclosed to him prior to his acceptance, which occurred when he paid for the product at the store.²⁵

In an opinion written by Judge Easterbrook, the seventh circuit court of appeals held that the buyer was given notice of the licensing restriction because acceptance only took place, not when the buyer paid for the product, but later—when the buyer opened the box, had an opportunity to read the license terms, and used the software rather than returning it. The buyer could not use the software until after he had opened the box and discovered the license, which he had a duty to read.

The opinion has been heavily criticized on two grounds. First, commentators complain that Judge Easterbrook misinterpreted offer and acceptance doctrine. Acceptance occurred at the time of purchase, they argue, and the terms-in-the-box are merely offers for additional terms, which can be accepted only by an affirmative “I agree” from the buyer, not by silence or non-rejection (White 2004). Indeed, pursuant to this logic, some courts have concluded that the terms-in-the-box are not binding on the buyers, even if they failed to return the goods.²⁶ Second, commentators argue that *ProCD* made a mockery of consumer protection. It put an excessive burden on buyers, who will often have trouble reading the additional terms after purchase, who might be surprised by the substance of some of the terms, and who will have to bear additional costs in returning goods to the seller (Macaulay 2004).

However, the case can also be read as pro-consumer case: it establishes, in partial form, a consumer right to withdraw. The crucial point, overlooked in the commentary, is that the buyer has the right to return goods merely because he changes his mind and no longer wants them. He is accorded an additional window of time to manifest his acceptance, and can withdraw—reject the “offer”—for any reason. If there is no acceptance, there is no contract—and therefore, he has no legal obligation to pay for the goods as long as he returns them. Thus, *ProCD* establishes what might be called an extended right to reject offers that serves the same policy functions, and has nearly the same practical consequences, as the right to withdraw.

However, the two types of rights—the extended right to reject offers and the right to withdraw—differ in a significant way. Where the right to withdraw exists, the initial contract establishes the terms governing the parties’ relationship prior to the point at which the right to withdraw is exercised or extinguished. The *ProCD* approach implies that the contractual terms do not govern during this period—because the contract does not yet exist. Instead, either default terms invented by courts must govern or the terms of the offer must govern (Epstein 2007). Suppose, for example, that the product is damaged during shipment from seller to buyer. Under the right-to-withdraw approach, the contract can allocate the loss. Under the *ProCD* approach, the contract cannot allocate the loss. It is possible that the seller could stipulate in the offer that the buyer is responsible for the loss, but is not clear that the buyer would be bound by such a stipulation if he does not accept the offer. In addition, under the *ProCD* approach, the seller can

²⁵ See *ProCD v. Zeidenberg*, 86 F3d 1447 (7th Cir 1996). See also *Hill v. Gateway 2000, Inc.*, 105 F.3d 1147 (7th Cir. 1997), which applied the *ProCD* theory to the purchase of a computer by telephone.

²⁶ *Klocek v. Gateway; Step Saver*

withdraw the offer or unilaterally modify aspects of it like the price, after the buyer has taken the product home as long as the buyer has not used it yet. This implication of *ProCD* goes against conventional understandings and makes little sense in economic terms. For these reasons, the right-to-withdraw approach is a cleaner response to the problem of consumer lack of information than *ProCD* is.

Another troubling aspect of *ProCD* is that it focuses on just one of the ways that buyers might learn about a product—by reading the legal fine print terms tucked in the box. Although the case is not entirely clear in this respect, it could be read to give the buyer the right to reject the offer only if he learns of hidden contractual terms that displease him. However, in our model the right to withdraw has a more general function: it should be available if the buyer learns anything about the physical or operational features of the product that do not match his desires. Indeed, buyers rarely read the terms, but they often identify physical and operational features that lead them to reevaluate the purchase. A right to withdraw that grants the buyers additional time to assess the value of the good reflects the reality of post-purchase information acquisition.

A final point is that, in one way, *ProCD* gives buyers *greater* protection than the right to withdraw does. The extended right to acceptance does not apply only to distance and off-premises contracts. Indeed, the transaction in *ProCD* took place in a store. Although buyers probably can obtain more information about goods when they purchase them in stores than when they purchase them from a distance, our theory of the right to withdraw suggests that this distinction is artificial, at best a crude proxy for the degree of information. As the *ProCD* case itself shows, buyers will often not obtain adequate information about goods at stores. If this is the case, the right to withdraw should be available for in-store transactions.

Right to reject nonconforming goods. Under the Uniform Commercial Code, the buyer has a right to reject delivered goods (§ 2-601) and a right to revoke acceptance of delivery (§ 2-608). If the seller delivers nonconforming goods, and the buyer discovers the nonconformity at the time of delivery, the buyer may exercise his right to reject the goods. If the buyer accepts the goods and only later discovers the nonconformity, the buyer may exercise his right to revoke acceptance. Rejection or revocation of acceptance, if not followed by cure on the part of the seller, entitle the buyer to remedies for breach including reimbursement of any payments.

These two rights differ from the right to withdraw inasmuch as the goods must be nonconforming. Thus, unlike the right to withdraw, the right to rejection is essentially a self-help procedure, a “pre-remedy” for breach of contract. However, the right to revoke acceptance recognizes the two major factors that underlie our analysis of the right to withdraw: that buyers may not discover problems with goods until they have had sufficient time to inspect them through use, and that goods depreciate over time and with use. Hence § 2-608 provides that “[r]evocation of acceptance must occur within a reasonable time after buyer discovers or should have discovered the ground for it and before any substantial change in condition of the goods which is not caused by their own defects.” Both § 2-601 and § 2-608 protect the seller by penalizing buyers who take too much time to inspect or damage goods while they are in their possession. Moreover, the rejection/revocation rules in the Code are consistent with the tradeoff

between information and depreciation. The longer the buyer waits to “return” the goods (and thus, the greater the expected depreciation), the more substantial the non-conformity must be to justify such return. Rejection, which usually occurs earlier than revocation of acceptance, can be exercised for any non-conformity. Revocation, in contrast, can be only exercised for substantial nonconformity.²⁷

Conditions of satisfaction. Some contracts, particularly service contracts, contain a provision that the seller’s performance must be to the satisfaction of the buyer. Courts distinguish contracts “relating to operative fitness, utility or marketability” and those involving “fancy, taste, sensibility, or judgment.”²⁸ Examples of the latter type include contracts for “the making of a garment, the giving of a course of instruction, the services of an orchestra, the making of recordings by a singer and the painting of a portrait.”²⁹ Buyers can escape contracts of the first type only if the performance would not satisfy a reasonable person. Buyers can escape contracts of the second type simply by being (honestly, but subjectively) dissatisfied with the product.

Here again we see judicial attention to the possibility that the buyer cannot learn about goods (or services) until they have been delivered (or performed). The right to avoid the contract because of an unsatisfactory performance verges on the right to withdraw in the second case—although presumably the buyer would not be permitted to reject the service merely because he can obtain it at lower cost elsewhere.

Consumer Protection Law. New York statutory law creates a right to withdraw that applies to on-premises sales, not just distance or off-premise sales.³⁰ However, unlike European law, sellers can opt out of the New York statute by conspicuously posting a sign with the store’s return policy—including a policy of not accepting returned items. California has a statute similar to New York’s.³¹ Other states recognize more limited rights to withdraw for transactions involving high-pressure tactics, such as telephone and door-to-door sales.

Should a right to withdraw be more formally recognized in American law? We think that there are good reasons for creating a default version of that rule. First, many, perhaps most, contracts between merchants and consumers give the buyer a right to withdraw. A default rule ratifying this pattern would save transaction costs and bring incomplete contracts in line with consumers’ expectations. Second, a limited version of this right has already been recognized in various areas of contract law—offer and acceptance, acceptance of goods, and conditions. Thus, recognition of a right to withdraw would be an incremental rather than radical change in the law. Third, the right to withdraw, like these other doctrines, reflects important policy considerations.

²⁷ U.C.C., § 2-607

²⁸ *Fursmidt v. Hotel Abbey Holding Corp.*, 200 N.Y.S.2d 256, 259 (1960).

²⁹ *Id.*

³⁰ N.Y. Gen. Bus. § 218-a.

³¹ Cal. Civ. Code § 1723.

It allows buyers to learn about goods and services that they purchase and to reject them if they value these goods and services less than they thought; and if sellers are protected from depreciation losses, the doctrine should work a Pareto improvement.

The proper scope of the right to withdraw is a matter of debate. It would make sense to limit it, at least initially, to distance contracts involving goods that (1) are complex, and (2) do not rapidly depreciate or depreciate in such a way that can be easily measured so that compensation can be calculated. A right to withdraw is most important for complex goods because these goods are the type that buyers need time to learn about. The right might also cover goods whose values can be ascertained only at home—for example, furniture that needs to match a house’s interior decoration. And a right to withdraw does least harm when the goods do not rapidly depreciate or the depreciation loss can be easily compensated. In some settings, it might be impractical for the seller to recover depreciation costs (for example, low-value goods) unless the seller demands a deposit and has proper market incentives to refund the entire deposit minus the depreciation cost.

Our argument does not imply that the right to withdraw should be a mandatory rule, as it is in Europe. If the reason that European jurisdictions make the right mandatory is the concern that vendors would otherwise routinely contract around it, this concern is misguided. Vendors usually opt into the withdrawal regime—as the examples of Wal-Mart and Target suggest. Return policy is not the type of fine-print term that goes under the radar, hidden from consumers’ plain sight. Buyers seek information about the sellers’ return policies, because most buyers anticipate returns as a non-trivial contingency. Indeed, return policies are regularly posted in a conspicuous manner. EBay auction items, for example, display information about the item, shipping, and the return policy. There are unique circumstances, few and far between, in which the mandatory nature of the right might be justified on the basis of asymmetric information. Door-to-door sales is perhaps one such context. But beyond these cases, the optimal contract containing a right to withdraw need not be mandatory. Parties should have the freedom to waive their right to withdraw for a discount, because there are situations—for example, when buyers can easily inspect the product and depreciation costs are high—in which the right to withdrawal is not advisable.

Conclusion

We have provided a model that shows that the right to withdraw makes economic sense when the buyer most efficiently learns of a product through use or inspection at home, and the product either does not depreciate rapidly or does depreciate but in a fashion that can be easily measured and compensated for. The right to withdraw does not yet exist in American law, but recognition of a default version of such a right would be an incremental change, one that could be implemented by a legislature or developed by courts on the basis of extensions of precedent.

Our support for the right to withdraw rests on general features of commercial transactions, not on traditional notions of consumer protection, and this raises the question

whether commercial buyers should have a right to withdraw. Indeed, the argument could apply to the mergers of firms and other complex transactions.

We believe, however, that such an extension of the right to withdraw beyond consumer transactions would be unwise. Consider first the case of business-to-business sales—parties purchasing inventories and lots from suppliers and manufacturers. In these cases, buyers typically have a great deal of information about the products because they constantly buy, hold, and resell them. They sample and inspect the goods prior to completing the purchase, and negotiate payments and setoffs according to ex-post measures of quality. Accordingly, there is less reason, compared to the consumer setting, for believing that the buyers need a post-sale interval to learn about the products that they purchase. And, in the case of wholesalers and retailers, the buyers do not use the products; they simply stock them until the products are resold. So there is narrow scope for learning. Further, if buyers can return products, they have weakened incentives to handle them carefully while they hold them.

Mergers pose a complex case where the benefits and costs of withdrawal are both high. Buyers of businesses, especially large businesses, may not obtain a full understanding of them for months or years—as several spectacular merger fiascos in recent years illustrate. The reason is that much of the value of the business is a function of intangible or hard-to-value features of it such as the morale of employees and the corporate culture. But the “return” of a business will impose high costs on the seller. If buyers know that they can withdraw from mergers, they can use the purchase of a business as an opportunity to learn trade secrets and sow turmoil in a competitor. Merger parties typically handle these problems on a case-by-case basis. The seller gives the buyer an opportunity to inspect its books and other aspects of the business prior to the closing of the deal, and contractual terms such as material adverse condition (MAC) clauses give the buyer the option to opt out under narrow conditions.

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Appendix

The proof goes as follows. We showed earlier that a transaction should be entered into iff $q \times v_H + (1 - q)[(1 - \theta)(c - d_1) + \theta v_L] > c$. Namely, it should be entered into iff

$$v_H > \frac{1}{q}[c - (1 - q)[(1 - \theta)(c - d_1) + \theta v_L]]$$

Compare the right hand side of this social optimum condition to the right hand side of the condition that determines the private incentives to enter transaction. First, examine the case in which $v^{**} > v_L > v^*$, namely $c - d_1 > v_L > c - d_2$. the r.h.s of social optimum conditions is less than that of the private incentives:

$$\begin{aligned} & c + \frac{1-q}{q}((1-\theta)(c-d_1) + \theta d_2) - \left(\frac{1}{q}[c - (1-q)[(1-\theta)(c-d_1) + \theta v_L]] \right) = \\ & = -\frac{1-q}{q}c + \frac{1-q}{q}((1-\theta)c + \theta(v_L + d_2)) > \\ & > \frac{1-q}{q}(-c + (1-\theta)c + \theta(c - d_2 + d_2)) = 0 \end{aligned}$$

When $v_L > v^{**}$, the distortion is greater. Here, the transaction should be entered into whenever

$$v_H > \frac{1}{q}(c - (1-q)v_L)$$

comparing the right hand side of this condition with that of the private incentives, when $v_L > c - d_1$:

$$\begin{aligned} & c + \frac{1-q}{q}((1-\theta)d + \theta d_2) - \left(\frac{1}{q}(c - (1-q)v_L) \right) = \\ & = -\frac{1-q}{q}c + \frac{1-q}{q}((1-\theta)d + \theta d_2 + v_L) > \\ & > \frac{1-q}{q}(-c + (1-\theta)d + \theta d_2 + c - d_1) = \\ & = \frac{1-q}{q}\theta(d - d_1) > 0 \end{aligned}$$

QED

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