



Journal of Applied Sciences

ISSN 1812-5654

science
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Information's Disclosure and Transmission on Contract Law: An Economic Analysis

Yongyong Zhu

Chongqing University of Education, 400067, Chongqing, China

Abstract: At this stage of the market economy environment, due to the impact of a variety of external factors, there is a large degree of information asymmetry in the process of contract's formation and implementation. This has resulted in imbalance of interests of both sides of the market transaction to a certain extent, as well as the trading relationships and contractual arrangements are not fair which are seriously impacting on social equity and justice. This article study the impact of the information's exchange, disclosure and transmission on contract law in the case of information asymmetry from the point of view of the law economics, from the point of view of the productive and distribution of information, express and implied information, the exchange of information and the disclosure of information, in order to reduce the impact on the contract because of the asymmetric information during the process of enterprise information disclosure and conduction, promoting the information on the formation of contracts positive feedback mechanisms, effectively enhancing the efficiency of the signing of contract, performance, modification, transfer and implementation.

Key words: Contract law, productive information, economic analysis, information transmission

INTRODUCTION

Contract is an agreement that two or more parties establish, change or terminate their civil relationship. A lawfully established contract is protected by laws and it is an important means of carrying out the economic activities, achieving commodity and service circulation. As the assembly of things and their attributes, information is the manifestation of the motion state and existing way of things and the removal of uncertainty. From the perspective of economics, Tan *et al.* (2012) and Jacobi and Weiss (2013a) studied show that the contractual relationship covers all kinds of beneficial exchanges established by the involved parties. Since information is a commodity, its production, transfer, use and pricing are also under a certain degree of control. Information exchange is the basis of establishing a contract. Therefore, when a contract is established, performed, changed or transferred, the transfer and exchange of information have to be conducted to guarantee both the performance of a contract and the interests of the involved parties. The influence of information distribution on the establishment of a contract, the productive information and distributed information on the disclosure of contract and the explicit information and implicit information on the explanation of contract constitutes the basic problems for researchers working on the Contract Law to research under the frame of economics.

MATERIALS AND METHODS

Owing to the difference of each party's understanding about information in political and economic activities, information asymmetry appears. Some members who possess more information are in a favorable position while others who possess less information are in an unfavorable position. Information asymmetry may cause the inequality in the interest distribution, transactional relationship and contractual arrangements of both parties of a contract. In addition to this, it may also reduce the efficiency of the market and even damage social equity and fairness. Information asymmetry is the primary problem for the contract law to deal with. For a contract, its ultimate aim is to maximize the exchange efficiency. Information asymmetry usually refers to a situation where one party has a good knowledge of some details in the contract which is less known or unknown to the other party. How to transfer resources to a subject with the best evaluation on them is the goal of the Contract Law. The reason why the subject is willing to pay a higher price than the existing subject is that he/she is able to use the resource more efficiently and profit from it. From the perspective of economics, the evaluation and usage of resources are built upon how to make best uses of the resources and the best distribution of the information is that the user of the resources is the same one who has the good knowledge of the information of the resources. Those who are in possession of the

resources but are unable to make best use of them can't gain best profit from them and others who possess information but have no resources have no opportunity to use the resources. The separation of information and resources is the normality of socialization. How to effectively realize the exchange of information and resources as well as the integration of them becomes the key point of researching information distribution efficiency under information asymmetry. Therefore, De Haes and Van Grembergen (2009) and Viaggi *et al.* (2010) concluded that a system should be established based on the contract law to encourage the owners of the resources to maximize the use of both resources and information, reduce the cost in the integration and exchange of resources and information and realize the integration of resource ownership and information ownership.

From the perspective of Contract Law, in order to avoid low efficiency in information distribution under information asymmetry, we should start our research from the characteristics of information and the way it is obtained. Zhiguo (2013), Schmitz (2002) and Wang and Chou (2013) indicated that the information had the characteristics of identifiability, convertibility, transferability, reproducibility, utilizability and storability. Under the information asymmetry, the cost in the production of information is generally higher than that in the transfer of information. In the consumption of information, if the information is not exhausted due to less competition, there will be no conflict between both parties. In the situation where low-cost information transfer coexists with less competition, the information owners are unable to maximize their possession of profits from the information in the contract, resulting in the overflow of the profits from the information. Therefore, it is necessary to divide the way that information is acquired which can be divided into two classes, namely creative acquisition and occasional acquisition. Hensher and Stanley (2008) and Brandt and Ding (2008) thought that creative acquisition refers to the way that one acquires productive information by putting efforts and money while occasional acquisition refers to the way that one occasionally acquires the information by putting no effort and money. Therefore, to a great extent, we can assume that the one who occasionally acquires the information obtains the opportunity to steal profits from the one who puts into efforts and money. The consequences of occasional acquisition are the same as the compulsory disclosure of information to some extent which is unhelpful to the exchange and transfer of information. However, in practical use, although one obtains information with occasional methods and ways, it may still

cost him/her much in examining and distinguishing information. Apart from much money in distinguishing information, he/she is required to put efforts into the integration of the exchange of information and resources acquired. Only in this way, can inequality of information distribution be avoided under the information asymmetry.

In order to further analyze the influence of information asymmetry on contract, the following case is taken as an example. Mr. Wang is a lover of stamp collection. From his good friend Mr. Zhang, he knows that Mr. Zhu has a stamp. Though it is simply an ordinary stamp for Mr. Zhu, it is Mr. Wang's favorite. Therefore, after being introduced to Mr. Zhu by Mr. Zhang, Mr. Wang decides to buy this stamp from Mr. Zhu. A same stamp which is of low value and evaluation to Mr. Wang is of high value and evaluation to Mr. Zhu. Due to information asymmetry, the stamp is valued at two different prices by two subjects. As for this contract, Mr. Wang has spent much in searching for this stamp, so buying this stamp at lower price is some compensation for his cost in searching; while as the seller of the stamp, Mr. Wang has no right to cancel this contract unilaterally. This is the performance of a contract under information asymmetry. The performance of such contract is based on the creative acquisition of information which encourages social public to search and find the best use of resources and moves investment in information and total volume of information to a higher level. We might as well presume that the one who has signed a contract with Mr. Zhu is not Mr. Wang but Mr. Zhang who occasionally knows from Mr. Wang that Mr. Zhu's stamp is of high value. Since this contract takes effect, the owner of the stamp and the owner of the information have been integrated which ends the idle status of the stamp and gives the stamp deserved value evaluation and this contract should be performed. However, if Mr. Zhu excises the cancellation right when knowing the stamp has a higher value, the resource and the information will be integrated and owned by one subject. To the society, the two kinds of integration make the same effect. It is with occasionality instead of through his efforts that Mr. Zhang obtains his information which is asymmetrical to the information owned by Mr. Zhu. In this case, whether Mr. Zhu carries out his cancellation right or not, he will be supported by the Contract Law, because the final effects for both choices are the same. Here, the support of the Contract Law must be based on the fact that it is with occasionality that Mr. Zhang obtains his information. Due to the difficulties in testification, Contract Law acknowledges by default that the information should be creatively obtained. By entitling resource owners with the responsibility of citing

evidences, the law encourages them to maximize the use of available information about their resources but not to retain the separation of resources and information. Thus, the right to cancel the contract removes the possibility of obtaining information occasionally and encourages resource owners to explore the best using channel of the existing resources. When one resource owner doesn't use his right to cancel the contract, it indicates that he/she has nothing to do with the continuing use of the resource, because the exchange of resource is a kind of information transfer mechanism which represents that the buyer may make a better use of the resource than the seller.

RESULTS AND DISCUSSION

The information can be divided into productive and distribution of information in accordance with the use of the result. Hladjk (2004) indicated that the productive information create more social wealth of information on the basis of the information itself which can be able to substantively change the level of evaluation of transactions, the distributive information is the process of transferring to the other party by one of the main subjects due to the role of information, that is resulted in the transfer of wealth.

Impact of productive information on contract law:

Productive information is composed of two types of use, one is the new use of information resources and the other is the different combination of the information resources (Smith and Richard, 1990). The new use of information resources, such as the aforementioned stamp purchase case, Mr. Wang has strong professional knowledge and skills and be able to accurately determine the value of old stamps, thereby enhancing the value of the stamps. This professional skills can be identified as the impact of productive information on the contract. The different combination of the information resources usually occurs in the business process, such as enterprise assets using different combinations will produce different results, the combination of information resources will also have some impact on the operation of the enterprise. The productive information made up by the different ways will have an indirect affect for the disclosed information and thus having a direct impact on the execution of the contract. For example: If the object to be exchanged is productive information, we should allow the owner not to reveal the information, this in fact recognizing and giving the rights to the information owner that making use of the productive information to carry on the wealth creation and get profit, because if such production information is made public, the information itself has the characteristics of

high creating cost and low cost of reproduction, the non information owner who obtains this information can get higher information value with lower cost and thereby benefiting from it, in the long run, this will reduce the level of investment of society for productive information and reducing the social wealth level from the overall. From another point of view, we do not disclose occupied productive information will force the owners of resource to mostly optimize their own information acquirement behavior, because once the others first obtain the information through the channel, they can obtain resource ownership through legitimate transactions, achieving the unity of resources and information and making a profit, the original owner who lost ownership of the resources will lost the opportunity to gain more revenues, So ased on the principles of fairness of contract law, for parties' contract formed based on productive information, contract law should be given to the implementation.

Impact of distribution information on contract law:

Relative to the productive information, the distributive information provides the opportunity to grab the others' wealth which does not raise the creative level of social wealth, just changing the distribution of social wealth, does not change the total wealth of the society. Jacobi and Weiss (2013b) and Adewale *et al.* (2012) analyzed the government's urban development planning in advance and according to the plan we buy the business district land with low prices in advance, after the announcement of the government planning, we sell the land at high prices to get profit. Informed the information of the government's urban development planning in advance is the transfer of wealth information, before the government announces the urban development planning, the land prices are lower. Acquisition of land for reserves in accordance with the price prior to the announcement of the urban development planning, waiting for the government plan is announced, the land changes from the lower utilization value rise to the higher utilization value of the business district land, at last sell the land at high prices to get profit. Informed the information of the government's urban development planning in advance neither to promote the use of the land, nor bring new land use which is purely an information arbitrage behavior. From the perspective of contract law, the established contract with thus means, contract law cannot perform it which neither prejudice to existing social wealth, nor encourage the society to carry out the investment to obtain distributional information. Thus investment is not only a waste of resources but also constitute a threat to social existing property rights system, improve the social security costs.

The Information property can be divided from the production point of view and distribution point of view, even though the information can be effectively divided from a theoretical point of view but in real life, the more information is appearing with the dual carrier identity of production and distribution, it all has dual nature, for the contracts which not only can improve the efficient use of resources but also can produce the result of the transfer of wealth, this mixed nature of the use of information if be able to contribute to the high efficiency of resources which need to embody by according to the resources in the future use of value. From the arrangement of the system and design aspects, contract law assumes that all of the information has production nature, unless the owner of the resource proves the information is a pure nature of transfer of wealth, otherwise the contract will be implemented, contract transactions are accompanied by a transfer of wealth transfer, if use this reason to demand the contract is invalid or the revocation of the contract, the system stability of contract law pursued will cease to exist. Therefore, in the premise of asymmetric information, the effective use of productive information and distribution information will make it better serving for the signing of contract and the implementation (Fishman and Hagerty, 1990).

Impact of information exchange on contract law: Fraud is the meaning that the party has understanding error occurred due to someone else's deliberate misrepresentation from the perspective of contract law which constitutes an civil act of fraud, fraud belongs to deliberately pass wrong message from the information point of view. Misrepresentation is an error in the expression of the true information and it also belongs to the problem of the transmission of information. Hatzis (2002) and Grof *et al.* (2012) asserted that in addition to fraud and misstatement, the parties may also exist misunderstand each other's meaning in the process of information exchange, such as the mutual misunderstanding of each other's intention, or only one of the parties misunderstand each other's meaning, this is a common misunderstanding. Both meaning expressed that despite real in the common misunderstanding but the two sides do not form a consistent, there may appear the two sides negotiate on the subject matter but find the subject matter is not the same subject matter in process of the negotiation, when this misconception is to be eliminated, the expressed content of two sides' meanings is to bring about essential changes, the resulting common misunderstanding will lead to the legal validity of the contract is invalid, the above is the misunderstanding based on between the two sides in the process of

information exchange. The most difficult to identify and deal with is that the unilateral information misunderstanding, because in the process of information exchange, if one party truly and accurately express their own meaning and accurately understanding each other's meaning but the other one misunderstood the meaning of one's expressed and then making a response according to the meaning after misunderstanding, Once this misconception eliminated, the misunderstanding party will certainly modify its meaning. Therefore, from the point of view of formation of the contract, with the unilateral misunderstanding, the two sides did not form a consistent meaning that the contract does not set up but if the unilateral misunderstanding is difficult to be verified and testified, that will be easily as an excuse to evade contractual obligations. For example, when the contract is signed, the party requires the termination of the contract with the reason that the unilateral misunderstanding which is seriously detrimental to the original intention of the conclusion of the contract, resulting in a very large impact on the system of contract law, so unless there is sufficient evidence to prove the existence of unilateral misunderstanding, generally do not accept the unilateral misunderstanding, so the contract will not be terminated.

Impact of disclosure of information on contract law: Information disclosure includes voluntary information disclosure and mandatory information disclosure. Nocco and Stulz (2006) pointed that voluntary information disclosure most is the enterprise's autonomous behavior, the disclosure of information independently determined by the enterprise management department based on the needs of information users and enterprise itself actual situation, the disclosure form of voluntary information disclosure is flexible, content is diverse, the carrier, format, indicators set as well as the arrangement style etc of the disclosure are all have uncertainty. Hylton (2003) pointed that mandatory information disclosure is usually an information disclosure system that the company in accordance with the relevant provisions of laws, regulations and constitution must disclose the information. For a company, the contents of the disclosure including the company overview and the information of main business, the basic financial information, material related transactions information, audit opinion, the shareholders and directors personnel information and other basic information, the form of disclosure including the three forms of announcement, provisioning and online promotion.

Whether voluntary information disclosure or mandatory information disclosure, they are both distributive information from the perspective of

information, the final result is to improve the efficient use of resource but both of them still exist essential difference, that is the information of mandatory disclosure may lead to a decline in the value of the use of resources, the reason that leading to both of them exists essential difference is the mandatory information disclosure may be the security information, such as the improper use of resources will lead to dangerous information and the information of resources defective. If the enterprise carries out the trading of resources, there is no disclosure of security information, the new resource users are at risk and the resulting accident will cause the loss of community wealth, therefore, contract law and other relevant laws require companies must disclose this information, the non-disclosure of information owners will bear the responsibility for compensation for damage. But such disclosure of mandatory information. We still need to think about its two-sided effect from two perspectives, although through the disclosure of mandatory information improves the level of the exchange of security information to a certain extent but from another perspective, that may lead to inadequate supply of security information, reducing the resource evaluation information and ultimately it is not conducive to the effective implementation of the contract. Therefore, from a business perspective, we need to carefully consider the disclosure of information on the impact of the contract; we need to take the appropriate carrier, form and manner to carry out the disclosure of information and to promote the formation of the information for the contract's positive feedback mechanism.

Impact of express and implied information on contract:

Starting from the perspective of the information whether express or implied information to study its impact on contract law, we are major researching the contract interpretation, the interpretation of the contract that is how to understand the information in the contract. The contract is a manifestation of consistent intention between the parties which needs to get a certain result by setting certain preconditions. The process of information is either express or implied can also be understood as a causal relation stipulated in the contract, in the case of stipulated contractual preconditions are met, we are getting the results of the performance of contract. If the precondition and result in the contract have no clear provisions and the clause with undetermined significance, or the terms is missing, at this time we need to explain the contract to build a complete precondition and result, as well as the causal relationship between the two ones.

The reasons of incomplete contract need to be explained are many, generally, there are three. First, the

rationality of the parties has limitations. For example, the prices of key raw material may have violent fluctuations after signing a contract and it may enable the parties' foresight of the factors which may affect the causality of contracting; the price of object may have changed when signing a contract and it also enabled the parties' fully knowing of the existed factors affecting the causality of contract; under the constraint of bounded rationality, the parties did not realize the limited capacity of their own expectations, otherwise, the parties may entered a supplementary provision into the contract. Secondly, cost constraint. For example, about the explicit information and implicit information, there is no clear and accurate definitions of each word and term of the contract and there is no possible situations of what might happen over the whole process of preparing the contract was into the consideration, although, such process may cost more to the parties. When the marginal cost exceeds the marginal income, the parties will rationally decided to leave some uncertainties of factors and flaws in the contract. Thirdly, the part of renegotiation is a way for the parties to reach a consensus on the meanings of terms of the contract by holding a secondary negotiation when the parties thought it is necessary to explain the contract. If there is no necessary to explain explicit information and implicit information, then, the uncertainties or the flaws of the contract shall remain unchanged, because, the unchanged uncertainties or the flaws of the contract may not directly affect the none-performance of the contract. In contract law, the interpretations of contract include literal interpretation, full-text explanation, teleological interpretation, common explanation and principle of good faith explanation, etc. Contract law also provides the provisions of explanation methods of standard form contract: Any disputes of understanding of form clauses shall be explained in accordance with common sense. If there are more than two explanations of form clauses, an explanation shall be made against the party who provide the form clauses. It is a mandatory provision and the application shall not be excluded by any agreement of parties.

To analyze the contract interpretation from explicit information and implicit information, the researchers Bester and Kraher (2012), Bloom *et al.* (2008) and Jalil and Pointon (2004) indicated that it can be discussed from three perspectives and it forms three theories of contract interpretation by the scholastics, in turns, the incomplete contract theory, the simulated full market theory and the theory of optimal allocation of risks. The incomplete contract theory researches the best arrangement of the contract between the principal and the agent when the contract is not able to reach a level of

complete due to all kinds of reasons and it mainly provides general interpretations against incomplete contracts or the contracts need to be explained. The parties may have a complex relationship because of the contract or performing the contract. Such relationship may be known by the parties; however, part of the information may not be verified to a third party except the parties such as a judge. Due to the reasons of explicit or implicit information, it may occur that the contract has the information which can be observed but cannot be proved and such information may lead to non-performance of the causality of the contract. Then, it is the duty of the incomplete contract theory to explain such existed but non-proved information. The simulated full market theory explains the contract by the parties' choices under a simulated circumstance of a full competition market when a contract has ambiguous meanings and loopholes that need to be explained. Because that the contract needs to realize the maximum of its conversion efficiency and needs a full competition market as its ideal environment, the simulated full market theory gives a theory thought of contract interpretation and the explanations formed and the result of performing the contract is in accordance with the result required by the principle of efficiency. The theory of optimal allocation of risks thinks that the optimal allocation of risks is an important target of contract law and the optimal risk allocation is to allocate all the risks that may happen during the progress of establishing and performing the contract to the party who can provide the optimal prevention. The process of risk allocation constitutes implied rules which explains the contract in accordance with implied rules when allocation of risks of the contract is not clear. For example, a buyer purchases a consignment from a manufacturer; they signed a formal contract but there is a lightning strike after signing the contract, seriously damaged the production equipment of the manufacturer, then, the manufacturer could not deliver the consignment according to the contract. Because such lightning matter was not stated in the contract, the factory can be exempted from the obligations for the failure of performing the contract due to force majeure according to the common contract law. But, if in accordance with the theory of optimal allocation of risks, for the prevention of lightning strike, the manufacturer belongs to the best party to take the prevention rather than the buyer, having more information of lightning probability and lightning prevention and the prevention income will transformed to be an income of the factory internally. The manufacturer did not take any actions of prevention and caused loss of the buyer, so, the manufacturer's obligation of performing the contract shall not be relieved.

Ambiguous meanings and loopholes of contract will affect the stability of transaction order and obscure the causal relationship established by contract. Rahman *et al.* (2012) maintained that if the interpretations of contracts are regarded as risks, one way to minimize the risk is to minimize the obscure level of contract and make it clear as much as possible. The principle of objectivism urges the parties to use the contract language in accordance with the social information standard and shifts the risk of inconsistency with the social information standard to the parties which has a deterrent effect. When the parties anticipate explaining from the view of subjectivism, the court will investigate the intention of parties and express clearly in the contract. There is no difference for the parties. Thus the parties are not willing to improve the clearness of contract and it will lead to more demands of interpretations of contract and therefore increase the social costs. For this reason, from the view of explicit information and implicit information, the principle of objectivism interpretation is better than the principle of subjectivism interpretation.

CONCLUSION

Under the economic environment at the present stage and due to the impacts of all external factors, there is so much of asymmetric information during the progress of conclusion and performance of contracts. And to some extent, it has caused the unbalanced interests of trading parties, injustice of transaction relationship and contract arrangements which seriously impact on the social equity and justice. In order to improve the efficiency of conclusion, performance, alteration, transfer and execution of contract, we studied the research of impacts on contract law by information exchange, disclosure and transmission under the law and economic perspective and proposed to classify the attributes of information from the view of productive information and distribution information. It can not only consolidate the foundation of improving the usage efficiency of resources but also lead to the transfer of wealth. Only by prudently considering the impacts on contract by information transfer system under the circumstance of asymmetric information from the information exchange and information disclosure perspective and the carrier, forms and ways to disclose the information, we can promote the formation of positive feedback mechanism of contract by information. By analyzing the interpretations of contract from the view of explicit information and implicit information and minimizing the obscure level of contract information under the condition of asymmetric information, it can make the form and contents of contract clear as much as possible,

shift the risks and responsibilities, lower the social costs and eventually decrease the impacts on contract due to asymmetric information during the progress of disclosure and transmission of enterprise information, promote the formation of positive feedback mechanism of contract by information and improve the efficiency of conclusion, performance, alteration, transfer and execution of contract.

ACKNOWLEDGMENT

This study is supported by the National Social Science Fund of China (No.12BFX085).

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