Washington Law Review

Volume 73
Number 2 *Focus on Fairness, Efficiency, and the Law*

4-1-1998

Focus on Fairness, Efficiency, and the Law. A Unified Theory of Justice: The Integration of Fairness into Efficiency

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A UNIFIED THEORY OF JUSTICE: THE INTEGRATION OF FAIRNESS INTO EFFICIENCY

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Abstract: An idea generally shared by both economists and philosophers is that a legal rule may either achieve distributive fairness or bring about an efficient outcome, but not both. In this Article, the authors argue that justice requires that legal rules consider both fairness and efficiency. The Article discusses the Coase Theorem, as a tool for determining the most efficient allocation of rights and duties, and the ideas of John Rawls for deriving a fair social contract. The authors then combine aspects of these two hypothetical consensus models into a unified theory of justice that considers the question of what agreements parties would enter into if they could bargain costlessly *ex ante* without knowledge of which side of the bargain they would ultimately obtain. The answers to this question, the authors contend, will form the basis for legal rules that give weight not only to fairness, but also to efficiency, and thereby will achieve just results.

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**B.A., Williams College; J.D., Stetson University. The authors thank and acknowledge the following for their helpful comments to earlier drafts or portions thereof: David W. Barnes, Harold J. Berman, Paul H. Brietzke, Mark Brown, William Carney, Anthony D'Amato, John J. Donohue, Richard A. Epstein, Peter F. Lake, Wesley J. Liebeler, Robin Paul Malloy, Henry G. Manne, Thomas D. Morgan, Marleen A. O'Connor, Russell K. Osgood, Richard A. Posner, Stephen Presser, Stewart J. Schwab, Lloyd Weinreb, and James Boyd White. We also thank the faculty of DePaul University College of Law, to whom one of us (Mike Swygert) gave a tentative version of our thesis in the fall of 1996, and especially Jane Rutherford for the sources she suggested to us.

I. INTRODUCTION

Is justice found in efficiency or in fairness? This is a fundamental question of contemporary jurisprudence.[1] Both the view of justice as fairness (having historical roots in natural-law theories) and the perception of justice as efficiency (with roots in legal positivism, especially utilitarian theories) assume that law and social policy are instrumental and that consequences matter.[2] Beyond that mutual assumption, fairness and efficiency discourses often diverge into separate worlds. But they need not. In this Article we merge these discourses into a unified theory of justice in which a concept of fairness as empathy is integrated into an efficiency construct that acknowledges and responds to influences of social norms.

A. The Dilemma of Postmodernism

In this postmodern era, diverse claims regarding normative bases for law and justice have earned respectability in scholarly works.[3]

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1. *See, e.g.*, Nicholas Mercuro & Steven G. Medema, *Economics and the Law: From Posner to Post-Modernism* 60 (1997) ("The concept of efficiency as justice is what many of the critics of the Chicago approach to law and economics find so troubling."); *id.* at 80 ("[Others] argue that legal-economic policy should [have a] concern for *both allocative and distributional impacts*, as well as a continuing concern for *justice and fairness*.") (citation omitted). Mercuro and Medema write:

> [An] issue is whether efficiency should play any role at all in the determination of what constitutes justice. This has become the arena of one of the most widespread arguments regarding the Law and Economics movement. Whereas Posner, for example, has argued eloquently that efficiency is moral and comports with the dictates of justice, others are equally adamant in their views that the use of the efficiency criterion in making law is antithetical to the idea that law should reflect some sense of justice.

Id. at 186; *see also* James Boyd White, *Economics and Law: Two Cultures in Tension*, 54 Tenn. L. Rev. 161, 198 (1987) (arguing that language of economics needs to be "integrated with . . . the rest of our culture").

2. Law is "instrumental" in that it is a means to an end rather than an end in itself. Ronald Dworkin argues that the consequences of legal decisions are critical to legal theory, that law is a social phenomenon wherein "it matters . . . how judges decide cases." Ronald Dworkin, *Law's Empire* 3 (1986). Competing jurisprudential theories share a common characteristic of attempting to explain how the law can work for just ends. *Id.* at 408–09.

3. Postmodern jurisprudence refers to the legal literature of the latter decades of the twentieth century that has departed from the century's mainstream perspectives—those predominately rational, positivistic, and natural law traditions that assert foundational truths, neutral principles, and transcendental values. These perspectives have been replaced, it is claimed, by "a more pluralistic, contextual, and nonessential explanation of law and legal decisionmaking developed for a multicultural society." Gary Minda, *Postmodern Legal Movements: Law and Jurisprudence at Century's End* 2 (1995). Minda discusses five postmodern legal movements: law and economics, critical legal studies, feminist legal theory, law and literature, and critical race theory. *Id.* at 83–185.

Postmodern theories, including law and economics,[4] critical legal studies,[5] law and literature,[6] critical race theory,[7] feminist jurisprudence,[8]

In addition to presenting an overview of these five postmodern jurisprudential movements, his book includes a brief discussion of construction theory as relating to social norms and meanings. *Id.* at 120–21.

One of the characteristics of postmodernism is that its theorists distrust "all attempts to create large-scale, totalising theories in order to explain social phenomena." Costas Douzinas et al., *Postmodern Jurisprudence: The Law of the Text in the Texts of Law* at x (1991).

For other discussions of postmodern legal theory, see John Lukas, *The End of the Twentieth Century and the End of the Modern Age* (1993), Neil Duxbury, *Faith in Reason: The Process Tradition in American Jurisprudence*, 15 Cardozo L. Rev. 601 (1993), Nancey Murphy & James Wm. McClendon, Jr., *Distinguishing Modern and Postmodern Theologies*, 5 Mod. Theology 191 (1989), Dennis Patterson, *Postmodernism/Feminism/Law*, 77 Cornell L. Rev. 254 (1992), and Peter C. Schanck, *Understanding Postmodern Thought and Its Implications for Statutory Interpretation*, 65 S. Cal. L. Rev. 2505 (1992).

4. The law and economics movement has had many central theorists over the last three-and-a-half decades. For a few of the most important, see Kenneth Arrow, *Social Choice and Individual Values* (2d ed., Yale U. Press 1976) (1951), David W. Barnes & Lynn A. Stout, *Cases and Materials on Law and Economics* (1992), Gary S. Becker, *The Economic Approach to Human Behavior* (1976), Guido Calabresi, *The Costs of Accidents: A Legal and Economic Analysis* (1970), R.H. Coase, *The Firm, the Market, and the Law* (1988) [hereinafter Coase, *The Firm, the Market, and the Law*], Robert Cooter & Thomas Ulen, *Law and Economics* (2d ed. 1997), Anthony T. Kronman & Richard A. Posner, *The Economics of Contract Law* (1979), Robin Paul Malloy, *Law and Economics: A Comparative Approach to Theory and Practice* (1990), Mercuro & Medema, *supra* note 1, A. Mitchell Polinsky, *An Introduction to Law and Economics* (1983), Richard A. Posner, *Economic Analysis of Law* (4th ed. 1992) [hereinafter Posner, *Economic Analysis of Law*], Richard A. Posner, *The Economics of Justice* (1981) [hereinafter Posner, *Economics of Justice*], Steven Shavell, *Economic Analysis of Accident Law* (1987), Gary S. Becker, *Nobel Lecture: The Economic Way of Looking at Behavior*, 101 J. Pol. Econ. 385 (1993) [hereinafter Becker, *Nobel Lecture*], Guido Calabresi, *Some Thoughts on Risk Distribution and the Law of Torts*, 70 Yale L.J. 499 (1961), R.H. Coase, *The Problem of Social Cost*, 3 J.L. & Econ. 1 (1960) [hereinafter Coase, *Social Cost*], Frank H. Easterbrook, *Ways of Criticizing the Court*, 95 Harv. L. Rev. 802 (1982), Charles J. Goetz & Robert E. Scott, *Principles of Relational Contracts*, 67 Va. L. Rev. 1089 (1981), Edmund W. Kitch, *The Intellectual Foundations of Law and Economics*, 33 J. Legal Educ. 184 (1983), Lewis A. Kornhauser, *The Great Image of Authority*, 36 Stan. L. Rev. 349 (1984), and Susan Rose-Ackerman, *Progressive Law and Economics—And the New Administrative Law*, 98 Yale L.J. 341 (1988).

5. For an excellent discussion of critical legal studies evolution, see Mark Tushnet, *Critical Legal Studies: A Political History*, 100 Yale L.J. 1515 (1991). Well-known critical legal studies publications include: Morton Horwitz, *The Transformation of American Law: 1780–1860* (1977); Duncan Kennedy, *Legal Education and the Reproduction of Hierarchy: A Polemic Against the System* (1983); Roberto Mangabelra Unger, *The Critical Legal Studies Movement* (1983); J.M., *Deconstructive Practice and Legal Theory*, 96 Yale L.J. 743 (1987); J.M., *Transcendental Deconstruction, Transcendent Justice*, 92 Mich. L. Rev. 1131 (1994); Clare Dalton, *An Essay on the Deconstruction of Contract Doctrine*, 94 Yale L.J. 997 (1985); Gerald E. Frug, *The Ideology of Bureaucracy in American Law*, 97 Harv. L. Rev. 1276 (1984); Peter Gabel & Joy M. Feinman, *Contract Law as Ideology*, in *The Politics of Law: A Progressive Critique* 172 (David Kairys ed., 1982) [hereinafter *The Politics of Law*]; Peter Gabel, *The Phenomenology of Rights-Consciousness and the Pact of the Withdrawn Selves*, 62 Tex. L. Rev. 1563 (1984); Mark G. Kelman, *Trashing*, 36 Stan. L. Rev. 293 (1984); Duncan Kennedy, *Form and Substance in Private Law Adjudication*,

and, more recently, construction theories involving social norms and meanings,[9] have gained increasing acceptance. Such theories are

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89 Harv. L. Rev. 1685 (1976); Duncan Kennedy, *The Structure of Blackstone's Commentaries*, 28 Buff. L. Rev. 205 (1979); Gary Peller, *The Metaphysics of American Law*, 73 Cal. L. Rev. 1151 (1985).

For overviews of the critical legal studies movement, see Andrew Altman, *Critical Legal Studies: A Liberal Critique* (1990), and Mark Kelman, *A Guide to Critical Legal Studies* (1987). For a bibliography of critical legal scholarship through 1983, see Duncan Kennedy & Karl E. Klare, *A Bibliography of Critical Legal Studies*, 94 Yale L.J. 461 (1984).

6. The publication in 1973 of University of Michigan Professor James White's *The Legal Imagination*, it is claimed, was the beginning of the postmodern law and literature movement. *See* Minda, *supra* note 3, at 149. White's project has been described as an attempt to demonstrate that the study of literature involved interpretative processes similar to ones used in the law. *Id.*; *see also* James Boyd White, *Justice as Translation: An Essay in Cultural and Legal Criticism* (1990); James B. White, *The Legal Imagination: Studies in the Nature of Legal Thought and Expression* (1973).

Other major contributions to the law and literature movement include: Richard H. Weisberg, *The Failure of the Word: The Protagonist as Lawyer in Modern Fiction* (1984); Richard Weisberg, *Poethics and Other Strategies of Law and Literature* (1992); Jane B. Baron & Julia Epstein, *Is Law Narrative?*, 45 Buff. L. Rev. 141 (1997); Daniel A. Farber & Suzanna Sherry, *Telling Stories out of School: An Essay on Legal Narratives*, 45 Stan. L. Rev. 807 (1993); Stanley Fish, *Working on the Chain Gang: Interpretation in Law and Literature*, 60 Tex. L. Rev. 551 (1982); Sanford Levinson, *Law as Literature*, 60 Tex. L. Rev. 373 (1982); and Ian Ward, *Law and Literature*, 4 Law & Critique 43 (1993).

7. For a bibliography of critical race scholarship through 1992, see Richard Delgado & Jean Stefancic, *Critical Race Theory: An Annotated Bibliography*, 79 Va. L. Rev. 461 (1993). *See also* Robin D. Barnes, *Race Consciousness: The Thematic Content of Racial Distinctiveness in Critical Race Scholarship*, 103 Harv. L. Rev. 1864 (1990); Kimberlé Williams Crenshaw, *Race, Reform, and Retrenchment: Transformation and Legitimation in Antidiscrimination Law*, 101 Harv. L. Rev. 1331 (1988); Jerome McCristal Culp, Jr., *Toward a Black Legal Scholarship: Race and Original Understandings*, 1991 Duke L.J. 39; Peggy C. Davis, *Law as Microaggression*, 98 Yale L.J. 1559 (1989).

8. The feminist literature is voluminous and often at odds within its paradigms. Among the well-known works are: Mary Joe Frug, *Postmodern Legal Feminism* (1992); Carol Gilligan, *In a Different Voice: Psychological Theory and Women's Development* (1982); Lucinda M. Finley, *Choice and Freedom: Elusive Issues in the Search for Gender Justice*, 96 Yale L.J. 914 (1987); Catherine A. MacKinnon, *Feminism, Marxism, Method, and the State: Toward Feminist Jurisprudence*, 8 Signs 635 (1983); Martha Minow, *The Supreme Court, 1986 Term—Forward: Justice Engendered*, 101 Harv. L. Rev. 10 (1987); Susan Moller Okin, *Sexual Difference, Feminism, and the Law*, 16 Law & Soc. Inquiry 553 (1991); Margaret Jane Radin, *The Pragmatist and the Feminist*, 63 S. Cal. L. Rev. 1699 (1990); Deborah L. Rhode, *The "No-Problem" Problem: Feminist Challenges and Cultural Change*, 100 Yale L.J. 1731 (1991); Ann C. Scales, *Towards a Feminist Jurisprudence*, 56 Ind. L.J. 375 (1981); Robin West, *Jurisprudence and Gender*, 55 U. Chi. L. Rev. 1 (1988); Joan C. Williams, *Deconstructing Gender*, 87 Mich. L. Rev. 797 (1989); Joan Williams, *Gender Wars: Selfless Women in the Republic of Choice*, 66 N.Y.U. L. Rev. 1559 (1991).

9. *See, e.g.*, F.H. Buckley, *Three Theories of Substantive Fairness*, 19 Hofstra L. Rev. 33 (1990); Elizabeth Hoffman & Matthew L. Spitzer, *The Coase Theorem: Some Experimental Tests*, 25 J.L. & Econ. 73 (1982) [hereinafter Hoffman & Spitzer, *The Coase Theorem*]; Elizabeth Hoffman & Matthew L. Spitzer, *Entitlements, Rights, and Fairness: An Experimental Examination of Subjects' Concepts of Distributive Justice*, 14 J. Legal Stud. 259 (1985) [hereinafter Hoffman & Spitzer, *An*

acquiring the recognition formerly reserved for traditional theories of legal positivism and natural law (including neutral principles) espoused by earlier legal theorists.[10]

Despite the growing acceptance of postmodern analysis, no cohesive postmodernist perspective consensus has been forthcoming. For example, Richard Posner suggests that a law and economics analysis allows decisionmakers to promote justice by deciding disputes with the object of the greater social good through wealth-maximizing resolutions.[11] In contrast, critical legal studies theorists (advancing a widely-varied set of propositions) deny that justice results from any analytic or economic model.[12] Some theorists have argued that claims of legal rights are merely political demands, declared by the powerful for the protection and preservation of their preferences.[13] Constructionists,

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Experimental Examination]; Richard H. McAdams, *Relative Preferences*, 102 Yale L.J. 1 (1992); Frank I. Michelman, *Norms and Normativity in the Economic Theory of Law*, 62 Minn. L. Rev. 1015 (1978); Cass R. Sunstein, *Behavioral Analysis of Law*, U. Chi. L. Rev. (forthcoming), *available in* Chicago Working Paper in Law & Economics No. 46 (visited Feb. 7, 1998), <http://www.law.uchicago.edu/Publications/Working/index.html>; Cass R. Sunstein, *Social Norms and Social Roles*, 96 Colum. L. Rev. 903 (1996) [hereinafter Sunstein, *Social Norms*].

10. Harold J. Berman has written that "[c]ontemporary American jurisprudence is in great need of its own historical roots in the jurisprudence of the past." Letter from Harold J. Berman, Woodruff Professor of Law, Emory University School of Law, to Michael I. Swygert, Professor of Law, Stetson College of Law (July 25, 1997) (on file with *Washington Law Review*). Berman perceives the conflict between justice as efficiency and justice as fairness as the contemporary battle between a political view of law (efficiency) and a moral theory (fairness). *Id.*

11. "A second meaning of justice, perhaps the most common, is—efficiency." Posner, *Economic Analysis of Law*, *supra* note 4, at 27. Posner adds that "there is more to notions of justice than a concern for efficiency." *Id.* In his 1981 book, *The Economics of Justice*, he wrote: "I have tried to develop a moral theory that . . . holds that the criterion for judging whether acts and institutions are just or good is whether they maximize the wealth of society." Posner, *Economics of Justice*, *supra* note 4, at 115. We read Posner's 1992 statements as "backing down" a little from his earlier strong efficiency-as-justice thesis of 1981.

12. James Boyd White, for example, has asserted that a person's motives and values are not exogenous to justice as presumed under a claimed normative theory of law and economics. James Boyd White, *Law as Rhetoric, Rhetoric as Law: The Arts of Cultural and Communal Life*, 52 U. Chi. L. Rev. 684, 698 (1985); *see also* Robin West, *Authority, Autonomy, and Choice: The Role of Consent in the Moral and Political Visions of Franz Kafka and Richard Posner*, 99 Harv. L. Rev. 384 (1985). For a survey of the variety of propositions advanced by critical legal studies scholars, see Minda, *supra* note 3, at 106–27.

13. One commentator describing critical legal studies has written that the law "cannot be more than a smokescreen concealing the efforts of the stronger to prey on the weaker." James Gordley, *The Philosophical Origins of Modern Contract Doctrine* 231 (1991); *see also* Amitai Etzioni, *The Spirit of Community: Rights, Responsibilities, and the Communitarian Agenda* (1993); Mary Ann Glendon, *Rights Talk: The Impoverishment of Political Discourse* (1991); Christina Hoff Sommers, *Who Stole Feminism? How Women Have Betrayed Women* (1994); Peter Gabel, *The Phenomenology of Rights-Consciousness and the Pact of the Withdrawn Selves*, 62 Tex. L. Rev. 1563 (1984); Mark

for their part, assert that the core law and economics assumption of rational self-maximizing does not reflect the empirically discoverable behavior in actual markets, and that peoples' choices are influenced at least in part by conscious adherence to or rejection of perceived social norms.[14] Postmodernists within the critical race and feminist movements attack notions of equality of individual rights, arguing that membership in racial or gender groups confers rights that at times trump the rights of individuals who are not within the group—the politics of identity.[15] Increasingly, postmodern theorists, predominantly feminists, are claiming that an ethic of care involving empathy needs to be more integrated into the law and its processes.[16] Similarly, many law-and-literature proponents advocate that law students, lawyers, and judges read works such as Kafka's *The Trial*[17] to become more empathetic to the abused, poor, or otherwise powerless members of society.[18]

On the surface, these rhetorical waves fall into seemingly incompatible categories.[19] On one hand, law and economics proponents

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Tushnet, *An Essay on Rights*, 62 Tex. L. Rev. 1363 (1984). *But see* Cass R. Sunstein, *Rights and Their Critics*, 70 Notre Dame L. Rev. 727 (1995).

14. *See infra* notes 30–31 and accompanying text.

15. *See, e.g.*, Derrick Bell, *And We Are Not Saved: The Elusive Quest for Racial Justice* 140 (1987); Finley, *supra* note 8; Duncan Kennedy, *A Cultural Pluralist Case for Affirmative Action in Legal Academia*, 1990 Duke L.J. 705; Randall L. Kennedy, *Racial Critiques of Legal Academia*, 102 Harv. L. Rev. 1745 (1989); Mari J. Matsuda, *Affirmative Action and Legal Knowledge: Planting Seeds in Plowed-Up Ground*, 11 Harv. Women's L.J. 1 (1988); Mari J. Matsuda, *Looking to the Bottom: Critical Legal Studies and Reparations*, 22 Harv. C.R.-C.L. L. Rev. 323 (1987); Martha Minow, *Not Only for Myself: Identity, Politics, and Law*, 75 Or. L. Rev. 647 (1996); Gary Peller, *Race Consciousness*, 1990 Duke L.J. 758.

For arguments against affirmative action or group rights, see, for example, Stephen L. Carter, *Reflections of an Affirmative Action Baby* (1991), Thomas Sowell, *Civil Rights: Rhetoric or Reality?* (1984), and Shelby Steele, *The Content of Our Character* 111–65 (1990).

16. *See infra* Part III.A.

17. Franz Kafka, *The Trial* (Alfred A. Knopf, Inc. 1956) (1937).

18. *See, e.g.*, Ronald Dworkin, *Law as Interpretation*, 60 Tex. L. Rev. 527 (1982); Linda R. Hirshman, *Brontë, Bloom, and Bork: An Essay on the Moral Education of Judges*, 137 U. Pa. L. Rev. 177 (1988); Richard H. Weisberg, *Three Lessons from Law and Literature*, 27 Loy. L.A. L. Rev. 285 (1993).

19. "Judge Richard Posner claims that the application of economic analysis to legal issues may be 'the most important development in legal thought in the last quarter century,'" notes Jonathan R. Macey, in *The Pervasive Influence of Economic Analysis on Legal Decisionmaking*, 17 Harv. J.L. & Pub. Pol'y 107 (1994) (quoting Posner, *Economic Analysis of Law*, *supra* note 4, at xix). In contrast, see Susan Moller Okin's article, *Reason and Feeling in Thinking About Justice*, 99 Ethics 229 (1989), discussing John Rawls's *A Theory of Justice* (1971). Okin writes that Rawls "has been the inspiration, in one way or another, for much of contemporary moral and political theory . . . , [a theory based] on empathy and concern for others." Okin, *supra*, at 246.

argue that legal rules should be applied to produce the most efficient, wealth-maximizing consequences, wholly apart from empathic considerations about the parties and their relative situations.[20] On the other hand, many within the critical race, feminist, law and literature, and critical legal studies movements claim that the efficiency norm is uncaring—that law is just only when it is fair, and that it is fair only when it is made and administered with empathy, that is, with a redistributive impact benefiting the economically and politically weaker members of society.[21] Reviewing the periphery of diverse notions advanced by postmodernists shows that each theorist asserts the superiority of his or her particular conceptual discourse.[22] Scholars on both sides find no middle ground. Efficiency and empathy, or efficiency and equity, are presumed to be irreconcilable.[23]

But are these normative goals incompatible? Is the economically efficient, wealth-maximizing world completely different from the world

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20. As Richard Posner has noted, "The most aggressive version [of law and economics] argues that economics not only explains the rules and institutions of the legal system but also provides the *ethically* soundest guide to improving the system." Posner, *Economic Analysis of Law*, *supra* note 4, at 25 (emphasis added).

21. *See, e.g.*, Gilligan, *supra* note 8; Nel Noddings, *Caring: A Feminine Approach to Ethics & Moral Education* (1984); Gertrude Nunner-Winkler, *Two Moralities? A Critical Discussion of an Ethic of Care and Responsibility Versus an Ethic of Rights and Justice*, in *Morality, Moral Behavior, and Moral Development* 348 (William M. Kurtines & Jacob L. Gewirtz eds., 1984); Okin, *supra* note 19, at 229–49.

22. "[T]he difference between various [postmodern] writers and thinkers is . . . the extent to which they take critical cognizance of the predicaments and paradoxes of their current intellectual situation." Minda, *supra* note 3, at 4.

23. "[T]he exercise of empathetic imagination lacks normative significance." Richard A. Posner, *Overcoming Law* 381 (1995). The incompatibility of justice as a caring or empathetic perspective and as a rights-oriented construct is said to be "an ancient theme." Judith Areen, *A Need for Caring*, 86 Mich. L. Rev. 1067, 1076–77 (1988). Ronald Dworkin has pointed out that contrasting jurisprudential arguments have real meaning: "Any practical legal argument, no matter how detailed and limited, assumes the kind of abstract foundation jurisprudence offers, and when rival foundations compete, a legal argument assumes one and rejects others." Dworkin, *supra* note 2, at 90.

The battles between various views of legal formalism versus views of legal realism are the central theme of Posner's *The Problems of Jurisprudence*. Posner writes that the masculine extreme outlook of law is legal positivism, while natural law reflects an extreme perspective of feminist jurisprudence. Richard A. Posner, *The Problems of Jurisprudence* 404–05 (1990). He notes, however, that the "ethic of care" realm is "not a female preserve," but that many of the influential male voices in the law have typified the ethic of care perspective, including Benjamin Cardozo and Justice William Brennan. *Id.* at 407. He might have added William O. Douglas and Earl Warren.

James Gordley has attacked the polarities of fairness and efficiency, asserting that "any viable theory of contract will have to take the fairness of a contract into account," while acknowledging that "there is no agreement [yet] as to how to do so." Gordley, *supra* note 13, at 230.

of fairness and empathy? And if the theoretical world, from which we derive principles of efficiency and wealth maximization, cannot be reconciled with the theoretical world in which notions of empathy and fairness are taken into account, then on what theoretical basis can we solve legal problems? For the law does not operate in a theoretical world. It operates in the real world, where legal problem-solving must take into account considerations of both fairness and efficiency.[24]

The objective of this Article is to explain how the law and economics focus on efficiency and wealth maximization as normative measures of good law and the claim of certain postmodernists that empathic care is a normative principle of justice can be integrated into a single theory, one that embraces the requirements of efficiency but is qualified by constructive empathy. Such reconciliation is possible because justice as empathy and justice as efficiency both theoretically result from a consensus.[25] Although each model has its own conditions for bargaining, these rules can be selectively combined into a single model.

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24. A commentator noted:

> [O]ur legal system should continue to reflect a complex mixture of not only our aspirations for an efficient economic system, but also our moral and political values. The life of the law should continue to be informed not only by economic logic, but social experience—even if it is complex experience.

Eric W. Orts, *Simple Rules and the Perils of Reductionist Legal Thought*, 75 B.U. L. Rev. 1441, 1479 (1995) (reviewing Richard A. Epstein's *Simple Rules for a Complex World* (1995)); *see also* M. Mitchell Waldrop, *Complexity: The Emerging Science at the Edge of Order and Chaos* 38 (1992) ("[Y]ou have to look at the world as it is, not as some elegant theory says it ought to be.") (quoting Stanford University Economics Professor Victor Norman).

An elegant expression of the "one-world view" has been provided by Michael J. Trebilcock in *The Limits of Freedom of Contract* (1993):

> Both as individuals and as a community, we do not operate within a one-value view of the world. . . . For economists to claim that they are interested only in maximizing the total value of social resources, without being concerned about how gains in the value of social resources are to be distributed . . . or while ignoring the impact of economic change on the lives of individuals or on the integrity or viability of long-standing communities, reflects a highly impoverished view of the world. Alternatively, theorists committed only to concepts of distributive justice, who proceed in their analysis by inviting us to assume a given stock of wealth, or a given increase in the stock of wealth, and then asking what a just distribution of that wealth might entail, are largely engaging in idle chatter as long as the wealth creation function is simply assumed. . . . Similarly, communitarians who stress values of solidarity and interconnectedness and discount values of individual autonomy and freedom risk pushing this perspective to an extreme, where communitarian values become exclusionary, authoritarian, or repressive.

Id. at 248 (citation omitted).

25. *See* discussion *infra* Parts II.A, III.D.

Before demonstrating this integration, it will be necessary to outline the basic tenets of each perspective. Part II of this Article reviews the concept of justice as efficiency as derivable from a hypothetical private consensus, focusing on the insights of University of Chicago economist Ronald Coase.[26] Part III turns to a discussion of the notion of justice as fairness (empathy), achievable by way of consensus, relying in part on the contractarian theory advanced by Harvard University philosopher John Rawls.[27] Although Rawls never applied his thesis to allocations of private rights and entitlements, two UCLA professors, Wesley Liebeler (law) and Armen Alchian (economics), have done so by developing a Hobbsean-Rawlsean *ex ante* contractarian rationale.[28] Part IV incorporates the ideas of Liebeler and Alchian in developing a consensus model for resolving private law disputes. In building our model, we also blend insights regarding law and empathy, especially those developed by Lynne Henderson,[29] to amplify and develop the thesis that empathy and efficiency can be merged into a theoretical construct in which both ends are achievable. Into this construct we also integrate elements of constructive theory, relying on studies of simulated marketplace behavior by Elizabeth Hoffman and Matthew Spitzer,[30] and the work of F.H. Buckley demonstrating the influence in the marketplace of the "fairness effect."[31] Finally, we set out and discuss several examples illustrating how our model could assist courts in resolving disputes.[32]

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26. For a compilation of Coase's writings applicable to law and economics, see Coase, *The Firm, the Market, and the Law*, *supra* note 4.

27. *See* John Rawls, *Political Liberalism* (1993) [hereinafter Rawls, *Political Liberalism*]; Rawls, *supra* note 19; John Rawls, *The Priority of Right and Ideas of Good*, 17 Phil. & Pub. Aff. 251 (1988).

For a detailed analysis of Rawls's philosophical theories, see Thomas W. Pogge, *Realizing Rawls* (1989); *see also* Peter F. Lake, *Liberalism Within the Limits of the Reasonable Alone: Developments of John Rawls's Political Philosophy, Its Political Positivism, and the Limits on Its Applicability*, 19 Vt. L. Rev. 603, 612 (1995) (noting that Rawls was intuitionist who acknowledged "that many moral decisions rest on rational and reasonable arguments . . . but that at *some* point(s), reference must be made back to a plurality of principles with no basis in justification other than 'they seem most nearly right'").

28. *See* Wesley J. Liebeler & Armen Alchian, *Constitutional Baselines by Virtual Contract: A General Theory and Its Application to Regulatory Takings*, 3 Sup. Ct. Econ. Rev. 153 (1994).

29. *See, e.g.*, Lynne N. Henderson, *Legality and Empathy*, 85 Mich. L. Rev. 1574 (1987).

30. *See, e.g.*, Hoffman & Spitzer, *The Coase Theorem*, *supra* note 9; Hoffman & Spitzer, *An Experimental Examination*, *supra* note 9.

31. *See, e.g.*, Buckley, *supra* note 9.

32. *See infra* Part IV.D.

B. *Summary of Argument*

In his seminal article, *The Problem of Social Cost*, Coase formulated the thesis that "if . . . market transactions are costless, . . . a rearrangement of rights will always take place if it would lead to an increase in the value of production."[33] Coase constructed an economic model by which he demonstrated a phenomenon that many legal theorists subsequently extolled as a prescriptive tool lawmakers (legislatures, governmental agencies, and courts) could use to bring about the optimal allocation of scarce resources and, by so doing, advance the greater welfare. This model has become commonly known as the Coase Theorem,[34] explored in Part II of this Article.[35] Coase's relevant postulation can be restated generally as follows: if all parties to be affected by a given situation could bargain costlessly, and if each potentially-affected party could come to the table with complete knowledge of all relevant factors, then the parties, in pursuing their preferences, would reach an agreement that would allocate their respective rights, obligations, and entitlements in a manner that would maximize the situation's total output.[36] Any agreement so reached would be efficient and wealth-maximizing.[37] Most significant about this justice-as-efficiency claim, especially as others have advanced Coase's work, is that any interference in the marketplace of legal relations should be made to promote efficiency and wealth maximization by emulating the bargain that would have resulted had there been no impediments (transaction costs).[38]

In contrast to the justice-as-efficiency theme is the claim of justice as fairness, considered in Part III of this Article.[39] John Rawls confronted the derivation of the principles of social justice in his 1971 book, *A Theory of Justice*.[40] Rawls emphasized the mechanism of a social contract and thus extended the works of earlier social contract theorists,

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33. Coase, *Social Cost*, *supra* note 4, at 15.

34. *See infra* Part II.

35. *See infra* Part II.B.

36. *See infra* Part II.B. The total output is the net increase in the total value of all the preferences desired by the parties.

37. *See infra* Part II.B.

38. *See* Richard Craswell, *Contract Remedies, Renegotiation, and the Theory of Efficient Breach*, 61 S. Cal. L. Rev. 630 (1988).

39. *See infra* Part III.

40. Rawls, *supra* note 19.

particularly Hobbes,[41] Locke,[42] and Rousseau.[43] Rawls added a methodology for the derivation of the principles of justice that postulated participants of a would-be society coming together in a hypothetical "veil of ignorance,"[44] under which they would know nothing about their own situations, but would otherwise be fully informed about human history, conditions, nature, and proclivities. Then, together, these parties would be able to agree on principles of governance, such agreement being achievable not only through a combination of the members' intuitive and rational mutual self-interests given what they knew, but especially on the basis of what they did not know. Rawls called this hypothetical assembly "the original position."[45]

The consensual model Rawls postulated in effect forces the participants in the original position to have empathetic knowledge of others since, as Susan Moller Okin has pointed out, any of the "others" may be themselves.[46] Through such rational self-interest, one becomes, it might be said, "constructively" empathetic of all others.[47] The core element in Rawls's model for deriving principles of justice is a mutually self-directed and self-serving consensus. Unlike the Coasean model for consensus, however, in Rawls's model, one's self-serving nature produces a result shaped in part by rational risk avoidance or hedging.[48] This risk avoidance results from the rational use of constructive empathy.[49]

Although Rawls and Coase make different assumptions about those who reach consensus, their assumptions regarding the process for

41. *See* Thomas Hobbes, *Leviathan, Parts I and II* (Bobbs-Merrill 1958) (1651) [hereinafter Hobbes, *Leviathan*]; Thomas Hobbes, *Human Nature*, in *The Elements of Law: Natural and Politic* (Ferdinand Tönnies ed., 2d ed. 1969) (1649). Many regard the latter as one of Hobbes's best works. *See, e.g.*, R.S. Peters, *Thomas Hobbes*, in 4 *The Encyclopedia of Philosophy* 31 (Paul Edwards ed., 1967).

42. *See* John Locke, *An Essay Concerning Human Understanding* (Peter Nidditch ed., Clarendon Press 1990) (1689); John Locke, *Two Treatises of Government* (Peter Laslett ed., Cambridge Univ. Press 1960) (1690) [hereinafter Locke, *Two Treatises*] (especially *An Essay Concerning the True Original, Extent, and End of Civil Government*).

43. *See* Jean Jacques Rousseau, *The Social Contract or Principles of Political Right* (Henry J. Tozer trans., Swan Sonnenschein & Co. 1895) (1762).

44. Rawls, *supra* note 19, at 136–42.

45. *Id.* at 17–22, 118; *see also infra* Part III.D.2.

46. Okin, *supra* note 19, at 243–49.

47. See discussion of "constructive empathy" *infra* Part IV.A.

48. *See infra* notes 301–06 and accompanying text.

49. *See infra* notes 305–06 and accompanying text.

achieving consensus are similar. Whether deriving principles for forming a just society or asking which party should be granted an entitlement, the process is to reason what the parties themselves would have agreed to *ex ante* if the obstacles to their bargaining had been removed.[50]

Rawls's consensus model is primarily a method for establishing overriding public law principles, while the Coasean zero-transaction-cost model has often been applied for the derivation of specific, private law. The term "public law" in this Article refers to governmental arrangements and constitutional provisions affecting the relations individuals have with the State, including those relating to constitutional and human rights. In contrast, "private law" signifies the powers, privileges, immunities, duties, rights, liabilities, and entitlements that define the juristic relations between and among individuals as derived either through private contracts or through public laws, regulations, and judicial decisions regulating or affecting those private relations. Given these definitions, law and economics concepts have had greater influence in the private law arena.[51] For example, a Coasean question for determining how a court will or should rule in determining the rights and obligations of the parties to a dispute is to ask what agreement the parties would have reached had they been able to bargain their juristic relations without transactional costs. Their bargain, Coase demonstrated, would be optimally efficient regardless of any initial set of entitlements.[52]

In many private relations, however, courts and other decisionmakers have not allowed what would be the most efficient "Coasean" result.[53] Consider circumstances in which extreme disparities in bargaining power exist and where markets are not competitive. Think of a low-level, non-unionized employee being hired by a large employer during periods of high unemployment, an out-of-work tenant dealing with a landlord during a housing shortage, or a low-income consumer buying goods on credit from a low-income-neighborhood retailer, and note the "interferences" with the parties' theoretical freedom to contract that courts and legislatures have imposed. These include minimum wage (and

50. Each theorist assumes there would be zero transaction costs in his respective consensus model, Coase expressly so, and Rawls by implication, because Rawls does not discuss the costs of the parties' learning of their eligibility to participate in or the costs of gaining needed information to operate in the original position.

51. *See infra* Part II.C.

52. The concept of initial entitlements is explained *infra* notes 81–85 and accompanying text.

53. For a discussion of some of the suggestions theorists have made as to how lawmakers may emulate the "Coasean" result, see *infra* Part II.C.

maximum hour) laws, workplace safety standards, rent-ceiling laws, the implied warranty of habitability, usury regulations, and legal doctrines such as unconscionability, to list a few examples.

In these and similar situations, the agreement that the parties are permitted to reach may be different from the agreement they would have reached had they been given the theoretical opportunity to bargain without transaction costs. This point becomes apparent upon examining the "one-sided" agreements that parties with little bargaining power often entered into prior to the restrictions or interferences of the law: employees worked twelve hours per day, six days a week, around dangerous machinery; low-income tenants lived in broken-down housing without heat, water, or electricity; consumers bought products at usurious rates of interest and with credit terms that upon default often resulted in losing not only the item purchased, but everything previously purchased from that seller.[54]

It is important to note that each of the above situations involved contracts freely entered into, meaning that *both* parties to the contracts believed themselves to be better off by entering into the bargain. In an economic sense, the agreements were wealth-maximizing. Each contract produced a net increase in marginal utility for each party, at least prospectively.[55] The reason these contracts strike us as "unfair" is not because the parties were forced into them—they were not—but because the disparity in bargaining power resulted in the stronger party receiving almost all of the surplus utility created by the transaction,[56] and because of a social norm of perceived "fairness" that finds offensive the disproportionate division of a transaction's surplus.[57]

If crafted under a theory of constructive empathy, some non-Coasean laws and judicial interferences could ensure that a "fair" portion of the surplus created by the transaction goes to and remains with the weaker party.[58] Although requiring empathy for the weaker party may appear inconsistent with Coasean analysis, this is not necessarily the case.

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54. *See, e.g.*, Williams v. Walker-Thomas Furniture Co., 198 A.2d 914 (D.C. 1964).

55. It often turns out that a contract, due to a variety of circumstances, becomes a "losing" one for one or more of the parties, meaning that the expected marginal gain in utility does not occur.

56. By "surplus utility," in this Article, we refer to the total combined net increase in marginal utility resulting from a transaction that is shared in whatever proportion by both parties to a transaction.

57. *See infra* Part IV.B.

58. *See infra* Part IV.C.

Coasean analysis helps determine which party would be granted a right or an entitlement in a efficient bargain. The fairness analysis we integrate here concerns the division of the surplus in the bargain that the Coase Theorem tell us the parties would reach. We must be concerned with the fairness of bargains, in part because the assumptions underlying the Coase Theorem do not hold true in the real world. In a perfectly competitive market, we would not need to be concerned with a bargain's terms; they would be set by the market. Unfortunately, transactions costs are never zero, and markets are not perfectly competitive. In the real world, as Coase said, "for anything approaching perfect competition to exist, an intricate system of rules and regulations would normally be needed."[59] Friederick Kessler pointed out over fifty years ago that parties to contracts often do not and cannot bargain in the traditional sense of making conscious trade-offs.[60] Rather, the stronger party often dictates the contract's terms, and the weaker party has the choice to "take it or leave it" (and sometimes not even that choice).[61] If the stronger party in a

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59. R.H. Coase, *The Firm, the Market, and the Law*, in *The Firm, the Market, and the Law*, *supra* note 4, at 9.

60. Friedrich Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 Colum. L. Rev. 629 (1943). According to Kessler, the phrase "contract of adhesion" was first used by Patterson in his 1919 *Harvard Law Review* article, *The Delivery of a Life Insurance Policy*. Kessler, *supra*, at 632 n.11; *see also* Todd D. Rakoff, *Contracts of Adhesion: An Essay in Reconstruction*, 96 Harv. L. Rev. 1173 (1983). Rakoff lists seven characteristics of a contract of adhesion:

(1) The document whose legal validity is at issue is a printed form that contains many terms and clearly purports to be a contract.

(2) The form has been drafted by, or on behalf of, one party to the transaction.

(3) The drafting party participates in numerous transactions of the type represented by the form and enters into these transactions as a matter of routine.

(4) The form is presented to the adhering party with the representation that, except perhaps for a few identified items (such as the price term), the drafting party will enter into the transaction only on the terms contained in the document. This representation may be explicit or may be implicit in the situation, but it is understood by the adherent.

(5) After the parties have dickered over whatever terms are open to bargaining, the document is signed by the adherent.

(6) The adhering party enters into few transactions of the type represented by the form—few, at least, in comparison with the drafting party.

(7) The principal obligation of the adhering party in the transaction considered as a whole is the payment of money.

Id. at 1177 (citations omitted).

61. Kessler referred to "take it or leave it" in French as "*à prendre ou à laisser.*" Kessler, *supra* note 60, at 632; *see also* Melvin Aron Eisenberg, *The Bargain Principle and Its Limits*, 95 Harv.

non-competitive market lacks empathy for the weaker party and is not, through the interference of the law, constructively required to be empathetic, a one-sided surplus of utility will result.

Although situations involving disparities in the bargaining power of the parties are commonplace in society,[62] when such disparities occur in non-competitive markets, problems arise. In such circumstances, the Coase Theorem provides neither predictability, in that it does not give us the result that decisionmakers themselves reach in the real world, nor a proper normative direction, in that it fails to suggest a result that decisionmakers should reach. To be more "realistic," the Coase Theorem needs to be modified by incorporating into it a component of fairness—a component of rational constructive empathy.[63]

Rawls's assumption that the parties to a consensus have limited knowledge about themselves under a "veil of ignorance" provides a theoretical way to create constructive empathy. Although Rawls primarily applied this restrictive knowledge assumption to the derivation of principles for public law, this Article demonstrates that, by adding to the Coase Theorem a condition of "hidden identity,"[64] both efficiency and fairness considerations can be integrated into the realm of private law.

A Rawlsean type of limited-knowledge assumption may be integrated into the Coase Theorem by changing the rules for entry into Coase's model. The question becomes what agreement the parties would reach if they were able to bargain costlessly and *ex ante*, assuming that they have full knowledge of all of the costs, benefits, and alternatives available to each of them, *but that they do not know which party to the agreement they will be.* Any agreement that the parties would reach under these

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L. Rev. 741 (1982). "[M]any contracts are made in markets that are highly imperfect." *Id.* at 750. "[A] new paradigmatic principle—unconscionability—has emerged. This principle explains and justifies the limits that should be placed upon the bargain principle on the basis of the quality of a bargain." *Id.* at 799. Failing to place limits on the bargain principle, Eisenberg concluded, will involve "greater costs to the system of justice" than placing such limits. *Id.* at 801.

62. For example, Professor Stewart Schwab has pointed out to us that when going to a chain grocery outlet to purchase a box of cereal, the customer has no power to bargain individually with the store owner over the price or contents of the box. Yet, a competitive larger market exists for cereal, and the lack of the individual's effective bargaining power resulting in a "take it or leave it" option does not render the sale an "unfair" bargain. Letter from Stewart J. Schwab, Professor of Law, Cornell Law School, to Michael I. Swygert, Professor of Law, Stetson College of Law (June 25, 1997) (on file with *Washington Law Review*).

63. *See infra* Part IV.C.

64. The term "hidden identity" is explained *infra* Part IV.C.

assumptions is one that will resolve the distortions caused by disparities in bargaining power within non-competitive markets. Any consequent agreement will be mutually accommodative in attempting to preserve each party's original utility gain. In short, it will be based on a hypothetical consensus involving a *condition of hidden identity* and a principle of *constructive empathy*, together with the influence of the social norms of risk aversion and perceived fairness.[65]

This method, moreover, still preserves efficiencies attainable from the Coasean hypothetical consensus model. In many, if not most, situations where parties have roughly equal bargaining power or where the markets are otherwise competitive, the results under this method will be essentially the same as they would be without the condition of hidden identity. To state this differently, when real bargaining is possible, in the absence of extreme disparities in bargaining power, parties who do not know their particular identities to a transaction will reach the same agreement as parties who know which positions they are bargaining for.

On the other hand, an agreement resulting under a Coasean model so modified would be different from the result reached under an efficiency-only model in a non-competitive market where a gross disparity of bargaining power existed between the parties. But, as will be demonstrated in Part IV below, agreements made under the hybrid Coase-Rawls model requiring use of the condition of hidden identity and the principle of constructive empathy would still be "efficient," in the sense that they would be transactions the parties would have entered into freely *ex ante* knowing their alternatives *and being risk averse.*[66] Risk aversion is a social norm affecting choice.[67] When parties act in response to risk aversion, any resulting "equitable gain" will occur at some point between the maximin[68] and the maximized total utility attainable.[69] If no

65. *See infra* Part IV.C.

66. *See infra* Part IV.A.

67. *See infra* notes 281–306 and accompanying text.

68. The "maximin" utility is the combined net increase in utility where the worst-off or weaker bargainer's benefits would be maximized, but at the cost of a lower marginal net increase in benefits for the stronger party. Rawls, Posner claims, preferred a set of arrangements that maximized the position of the worst off. Posner, *Economic Analysis of Law*, *supra* note 4, at 461.

69. The "maximized total utility" (in contrast with the "maximin") is the total combined net increase in utility that is possible within a situation. *Id.* at 462. The maximum increase in benefits may result in a 50/50 split between two parties to a bargain or, in theory, it could result in a 99/1 split, or anything in between, so long as whatever split there is results in the largest *combined* increase in total utility—the largest pie versus the larger slice notion.

resolution can be agreed upon that would be advantageous to all, the parties will walk away. Agreements that do occur will increase total welfare. The difference is that the increase in welfare will be more equitably shared. An agreement so made (or emulated) will be both efficient and fair.

II. JUSTICE AS EFFICIENCY

The Coase Theorem is a powerful economic tool for considering questions of efficiency and preference maximization. This tool allows for a derivation of agreements that parties would reach if they could bargain under a set of assumed conditions, including the assumptions that no transaction costs would hinder the bargaining and that perfect competition exists. Although these assumptions never hold true in real markets, examining what would happen if they were true allows us to comprehend and formulate policies and rules designed to promote efficient dispute resolutions. While the Coase Theorem can help us understand what is efficient, it alone cannot and was not meant to tell us what would be a "fair" allocation of resources among or between the parties.

A. The Coase Theorem

In his 1960 article, *The Problem of Social Cost*, Ronald Coase introduced the proposition, now known as the "Coase Theorem," that if market transactions are costless, a rearrangement of rights will always take place if it would lead to an increase in production value.[70] The topic that Coase addressed in *The Problem of Social Cost* was negative externalities.[71] The Coase Theorem, however, has been applied in many areas beyond the field of externalities, from the market for hepatitis-free blood,[72] to the appropriate Federal Communications Commission rules

70. Coase, *Social Cost*, *supra* note 4, at 15.

71. A negative externality is a divergence between the private cost of an activity and the social cost of that activity. If such a divergence occurs, and there is no government or market action to correct it, then the harmful activity, or the good that is produced by the harmful activity, will tend to be over-produced relative to its value to society. This misallocation of resources occurs because the cost structure faced by the producer does not reflect the true cost of production. Some examples of this that Coase uses are a smoky factory, a cattle rancher whose cattle stray onto the neighboring farmer's land, and a noisy confectioner next to a doctor's office. Coase, *Social Cost*, *supra* note 4, *passim*.

for cable television,[73] to markets in intellectual property,[74] to the separation of powers and declarations of war.[75]

Coase's ideas have been widely discussed in both economic and legal literature, and they have taken on a life of their own far beyond anything Coase ever suggested. *The Problem of Social Cost* has become the most cited article in both social science and legal literature.[76] The following restatements illustrate the wide range of functions attributed to the Coase Theorem:

> [U]nder perfect competition private and social costs will be equal.[77]

> In a world of zero transaction costs, the allocation of resources will be efficient, and invariant with respect to legal rules of liability, income effects aside.[78]

> [R]esource allocation is efficient regardless of the structure of liability law, providing that bargaining is frictionless.[79]

> [I]f nothing obstructs efficient bargaining, then people will negotiate until they reach Pareto efficiency.[80]

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72. Reuben A. Kessel, *Transfused Blood, Serum Hepatitis, and the Coase Theorem*, 17 J.L. & Econ. 265 (1974).

73. Stanley M. Besen et al., *Copyright Liability for Cable Television: Compulsory Licensing and the Coase Theorem*, 21 J.L. & Econ. 67 (1978).

74. Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 Colum. L. Rev. 2655 (1994).

75. J. Gregory Sidak, *To Declare War*, 41 Duke L.J. 27 (1991).

76. Daniel Q. Posin, *The Coase Theorem: Through a Glass Darkly*, 61 Tenn. L. Rev. 797, 806 n.40 (citing Institute for Sci. Info., Inc., *Social Sciences Citation Index*, and Fred R. Shapiro, *The Most-Cited Law Review Articles*, 73 Cal. L. Rev. 1540, 1546 (1985)).

77. George J. Stigler, *The Theory of Price* 113 (1966). Coase credits Stigler with being the first person to call the ideas in *The Problem of Social Cost* "The Coase Theorem." R.H. Coase, *Notes on the Problem of Social Cost*, in *The Firm, the Market, and the Law*, *supra* note 4, at 157.

78. Richard O. Zerbe, *The Problem of Social Cost in Retrospect*, in 2 *Research in Law and Economics* 83 (Richard O. Zerbe ed., 1980).

79. Robert Cooter, *The Cost of Coase*, 11 J. Legal Stud. 1, 4 (1982).

80. Joseph Farrell, *Information and the Coase Theorem*, 1 Econ. Persp. 113, 113 (1987). Pareto efficiency is defined as reaching a state of optimality at which it is not possible for the parties to make a trade that would make one party better off without making another party worse off. Posner, *Economic Analysis of Law*, *supra* note 4, at 13. This is a stronger form of efficiency than Kaldor-Hicks efficiency, which calls a transaction efficient if it increases total welfare, that is, if the benefit from the transaction is enough greater than the harm from it that any harmed parties could be compensated by parties made better off, whether or not the harmed parties actually are compensated. *Id.* at 14. Kaldor-Hicks efficiency has a broader scope than Pareto efficiency. If a transaction is

The Coase Theorem uses the process of reaching a consensus—bargaining—to discover the most efficient allocation of rights and obligations. Coase argues that, given the ability of both parties to bargain rationally without transaction costs, the allocation of resources will not change regardless of which party begins with a particular entitlement.[81]

Consider a dispute between two firms because the pollution created by one interferes with the production processes of the other. We can call one firm Polluter and the other Recipient. If Polluter is liable for the damage it causes Recipient, that is, if Recipient has an entitlement to be free from pollution, Polluter will produce up to the point (Q1*) at which the marginal revenue of one more unit of its product, Product 1 (P1), is equal to the marginal cost of producing that unit, including the cost of compensating Recipient for the amount of damage to the production of Product 2 (P2) caused by the production of P1. At levels of production below that point, the increase in total revenues created by producing the next unit is greater than the increase in total costs generated by producing the next unit. At levels of production above Q1*, the cost of producing the next unit is not justified by the increase in total revenue that the next

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Pareto efficient, then it increases total welfare and it makes all parties to it better off. In contrast, if a transaction is Kaldor-Hicks efficient, it increases total welfare, but it does not necessarily make all parties to it better off. A transaction that is Kaldor-Hicks efficient increases total welfare enough that all parties *could* be compensated to make them better off, but Kaldor-Hicks efficiency does not require that they actually *are* compensated.

To illustrate the difference between Kaldor-Hicks and Pareto efficiency, we can go back to the farmer-rancher example. Let us say having one more head of cattle in his herd makes the rancher $10 better off. That additional head does $15 worth of damage to the farmer's crops. Now, compare two possible resolutions to this situation. First, the farmer could make a bargain with the rancher to pay the rancher $12 if the rancher refrains from adding one more head of cattle to his herd. Second, the farmer could seek an injunction. A court could determine that the farmer has an entitlement to have his land be free from trespassing livestock and grant the injunction.

In either of these cases, total welfare is increased by five dollars, so the result in both cases is Kaldor-Hicks efficient. However, only the first resolution is Pareto efficient. The rancher is two dollars better off and the farmer three dollars better off than if they had not entered into this bargain. In the second situation, the farmer is $15 better off, and the rancher is $10 worse off than if the injunction had not been granted.

Another way to look at this is to say that all of the parties affected would voluntarily enter into a transaction if it is Pareto efficient. However, if a transaction is only Kaldor-Hicks efficient, there will be some parties that would not enter into the transaction voluntarily. The transaction would have to be imposed by the government or the courts.

81. Coase, *Social Cost*, *supra* note 4, at 6–8. The word "entitlement," as used in discussing the Coase Theorem, can mean anything from the right to pollute to the right to refuse to sell one's property. *See infra* notes 114–16 and accompanying text.

unit of production will bring, and Polluter will not produce.[82] If there are no levels of production at which the marginal revenue of the next unit of P1 is greater than the value of P2 that is destroyed by the production of that unit, then Polluter will go out of business.

If Polluter is not liable for the damage that it causes and there is no possibility of transactions between Polluter and Recipient, then Polluter will produce up to the point at which the marginal revenue of producing the next unit equals the marginal cost to Polluter of producing that unit. This will not take into account the damage that the production of P1 does to the production of P2. The marginal cost to Polluter of producing P1 will be less than the marginal cost to society of its production. Therefore, the quantity of P1 produced will be greater then Q1*.

However, if Recipient does not have an entitlement to be free from pollution, and there are no transaction costs between the parties, according to Coase's argument, the allocation of resources will remain the same as it would if Polluter were held liable for the damage it caused. Polluter and Recipient will be able to reach a consensus that allocates rights and obligations between the parties in the most efficient way possible. For any level of production at which the value to Recipient of the amount of P2 destroyed by the production of the next unit of P1 is greater than the difference between the marginal revenue and marginal cost of that unit of P1 (Polluter's profit on that unit), Recipient will be willing to pay Polluter not to produce that unit. When Polluter is making its decision as to whether or not to produce the next unit of P1, it will take into account not only the marginal cost of producing that unit, but also the amount of payment from Recipient that it will forgo by producing it.[83] Therefore, Polluter will only produce up to the point at which the marginal cost of producing the next unit plus the marginal damage to the production of P2 is equal to the marginal revenue it will receive for that unit of P1. This will be Q1*.

Consequently, regardless of whether the Recipient has a right to be free from pollution or not, if there are no transaction costs, Polluter will produce up to the point at which the marginal social cost of that unit of P1 (marginal cost of production plus the value of the amount of P2

82. Coase, *Social Cost*, *supra* note 4, at 3. This is just a restatement of one of the fundamental principles of the economics of perfect competition, which is that firms will produce up to the point at which marginal costs equal marginal revenue.

83. *Id.* at 7.

destroyed by producing it) is equal to the marginal revenue of that unit.[84] While the liability rule may have distributional effects, in that it changes which party has to compensate the other, it has no effect on the allocation of resources, assuming no transaction costs.[85]

B. Assumptions Underlying the Coase Theorem

As Coase emphasizes, the ideas that became known as the Coase Theorem were not meant to represent the real world.[86] They describe a world bounded by a number of underlying assumptions. Understanding the nature and meaning of these assumptions is crucial to understanding what the Coase Theorem means and to evaluating discussions and applications of it.

Elizabeth Hoffman and Matthew Spitzer have written perhaps the most complete summary of the assumptions behind the Coase Theorem:[87]

(a) two agents to each externality (and bargain),

(b) perfect knowledge of one another's (convex) production and profit or utility functions,

(c) competitive markets,

(d) zero transaction costs[,]

(e) costless court system,

(f) profit-maximizing producers and expected utility-maximizing consumers,

(g) no wealth effects,

(h) [the striking by agents of] mutually advantageous bargains in the absence of transaction costs.[88]

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84. *See* Adam Gifford, Jr. & Courtenay C. Stone, *Externalities, Liability, and the Coase Theorem: A Mathematical Analysis*, 11 W. Econ. J. 260 (1973) (explicating mathematics behind this argument); M.T. Maloney, Note, *The Coase Theorem and Long-Run Industry Equilibrium*, 17 Q. Rev. Econ. & Bus. 113 (graphically representing this argument).

85. Coase, *supra* note 59, at 13.

86. *Id.* at 14.

87. For this reason, this Part will rely on Hoffman and Spitzer's categorization of these assumptions.

In essence, "(b), (d), and (e) are all part of the same assumption, . . . that bargaining is costless."[89] Several of these assumptions require further explanation.

1. Competitive Markets

Perfectly competitive markets are more readily understood in terms of what they are not than what they are. A perfectly competitive market operates in the absence of any monopoly power. No party to an agreement in a competitive market is significant enough to influence the market price or terms of agreement. There are no important differences in the product of one firm as opposed to another. There is nothing in the perfectly competitive market to prevent a new party from entering the market.[90]

In the competitive market, price is set by the intersection of the industry supply curve and the demand curve for that product. The industry demand curve is the horizontal summation of the demand curves of all of the individual consumers in that market and is represented as downward-sloping, because consumers are assumed to want less of a product as the price of the product increases. The industry supply curve is the horizontal summation of the supply curves of each of the firms in that industry. The supply curve for each firm is the upward-sloping portion of the marginal cost curve faced by that firm.[91]

If the market is competitive, each individual firm within the industry is assumed to be a price-taker. That is, the demand curve that each firm faces is horizontal and is set at the intersection of the industry supply and demand curves. No firm is large enough for its production decisions to

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88. Hoffman & Spitzer, *The Coase Theorem*, *supra* note 9, at 73. The assumption of perfect knowledge requires that all parties understand the costs and benefits of a decision, both to themselves and to other parties. "[It] means that consumers know the price charged by each producer. Providers of inputs (laborers and owners of capital) know how much each producer will pay for the resources they provide. Producers know the technology used by their competitors." Mark Seidenfeld, *Microeconomic Predicates to Law and Economics* 35 (1996).

89. Herbert Hovenkamp, *Marginal Utility and the Coase Theorem*, 75 Cornell L. Rev. 783, 789 (1990).

90. *See, e.g.*, Posner, *Economic Analysis of Law*, *supra* note 4, at 11.

91. Marginal costs represent the change in total cost with each unit of production. *See id.* at 8. The assumption that the firm supply curve is the upward-sloping portion of its marginal cost curve is a corollary of the assumption that the level of production at which profits are maximized, and therefore at which firms will produce, will be the level at which the marginal cost of producing the final unit is the same as the marginal revenue associated with that unit. *See* Seidenfield, *supra* note 88, at 29.

affect market price. Products are also assumed to be homogenous, so that the product of any one firm in an industry is identical to that of every other firm in the industry. A common example is the market for a particular grade of corn.

In competitive markets, entry is possible and will occur if the risk-adjusted rate of return in that industry is higher than the risk-adjusted rate of return available elsewhere. That is, if there are economic profits to be made, firms will enter the market, increasing the quantity supplied and driving down price. This means that, over time, the price for the product is at the minimum of the long-run industry average cost curve, and there are no economic profits.[92]

2. *Transaction Costs*

The existence of zero transaction costs is the most important assumption of the Coase Theorem. At the same time, for many, it may be the most difficult to understand, because the term "transaction costs" embraces many ideas. Pierre Schlag has identified two approaches to the definition of transaction costs.[93] One of these, which he calls the "ad hoc" approach, lists problems that commonly result in transaction costs, including free-rider,[94] holdout,[95] bilateral monopoly,[96] identification of

92. For a more mathematically oriented description of the economics of competitive markets, see Allan C. DeSerpa, *The Pure Economics of the Coase Theorem*, 18 E. Econ. J. 287 (1992).

93. *See* Pierre Schlag, *The Problem of Transaction Costs*, 62 S. Cal. L. Rev. 1661, 1673–76 (1989).

94. A free-rider problem exists when the provider of a good or service is unable to capture all of the value of that good or service because she is unable to exclude people from receiving the benefits of it. This can be a problem with the provision of positive externalities, or "public goods," and with the reduction of negative externalities. An example of this is pollution reduction. If a large group of property owners must negotiate with a polluting factory to reduce the amount of pollution, each property owner will have an incentive to understate how much she is willing to pay for the reduction in pollution, on the assumption that "[i]f I refuse to contribute my fair share of the purchase price, others, who care more deeply about pollution than I do, will make up the difference." Posner, *Economic Analysis of Law*, *supra* note 4, at 63. This may result in the parties not being able to reach an agreement, even if the reduction in pollution is valued more highly than the cost to achieve it. *Id.*

95. A "holdout" problem may exist when there is a large number of parties on the side to be compensated. Parties may have an incentive to overstate the value they place on the right being purchased in order to gain a larger portion of the compensation. If enough of the parties do this, the price for the entitlement will be too high, and the parties will be unable to reach an agreement, even though the side attempting to purchase the right values it more highly than the side to be compensated. *Id.* at 62–63.

96. A bilateral monopoly exists when both of the parties must negotiate with each other, if they are to negotiate at all. An example of this would be an "employee . . . trained in a set of techniques

contracting parties, information acquisition and production, policing of agreements, detection of breach, enforcement of agreements, valuation difficulties, and negotiation costs.[97] These categories, Schlag says, have the advantage of being easy to recognize and apply in legal cases.[98]

A better approach to transaction costs, according to Schlag, is the "definitional" approach.[99] The somewhat varying definitions of "transaction costs" that have been offered by different economists include:

> Costs that occur "when trading partners attempt to identify and contact one another (identification costs), when contracts are negotiated (negotiation costs), and when the terms of the contracts are verified and enforced (enforcement costs)."[100]

> The costs of bringing bargainers together, maintaining and revising the agreement, and the capital required to effect the agreement.[101]

> The costs "like those of getting large numbers of people together to bargain, and costs of excluding free loaders."[102]

> The three classes of "search and information costs, bargaining and decision costs, policing and enforcement costs [all of which amount to losses] due to lack of information."[103]

Transaction costs are likely to be higher in certain situations than in others. Harold Demsetz examined transaction costs within the New York Stock Exchange and found that the more a security is traded, the lower

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unique to his particular employer, while his employer pays the training bill." Herbert Hovenkamp, *Rationality in Law & Economics*, 60 Geo. Wash. L. Rev. 293, 308 (1992). In such a case, "[t]he employer is willing to pay a premium to retain an employee who is already trained; the employee is worth more only to . . . his current employer." *Id.* Bilateral monopoly may lead to strategic behavior, on the part of both the employer and employee, that raises the costs of negotiation dramatically: for example, a strike that shuts down a plant or a firm that provides income for both the employer and employee.

97. Schlag, *supra* note 93, at 1673.

98. *Id.*

99. *Id.* at 1674.

100. *Id.* at 1675 (quoting Peter G. Toumanoff, *A Positive Analysis of Market Failure*, 37 Kyklos 529, 531 (1984)).

101. *Id.* (citing E.J. Mishan, *The Postwar Literature on Externalities: An Interpretive Essay*, 9 J. Econ. Lit. 1, 16 (1971)).

102. *Id.* (quoting Guido Calabresi, *Transaction Costs, Resource Allocation, and Liability Rules—A Comment*, 11 J.L. & Econ. 67, 68 n.5 (1968)).

103. *Id.* (quoting Carl J. Dahlman, *The Problem of Externality*, 22 J.L. & Econ. 141, 148 (1979)).

the transaction costs are for trading in that security.[104] Further, the standardization of a product makes buyers willing to "let others buy and sell for them" and to purchase without personally examining the goods, which Demsetz found also reduced transaction costs.[105] Examining the characteristics of various types of bargains, Oliver Williamson argued that the characteristics that tend to increase transaction costs are a high level of uncertainty, infrequent exchanges, and the level to which investments are transaction-specific.[106]

3. *Wealth Effects*

A wealth, or income, effect is a change in the demand for a particular good or entitlement caused by a change in wealth or income.[107] The reason that the absence of wealth effects is required as a background assumption of the Coase Theorem may not be immediately clear. However, one facet of the Theorem holds that the allocation of resources does not change with a change in the liability rule.[108] This outcome depends on the windfall gain or loss from the reallocation of an entitlement either being planned for or not having a wealth effect. It is possible that, if bargaining is costless, the potential for a change in the legal rule will already be accounted for in agreements between parties, so that all contingencies will be provided for and no redistribution of wealth could occur.[109] A newly-recognized right that was not planned for in previous agreements, however, may increase or decrease demand for some goods. If the right being created is new, and it could not have been planned for in previous agreements, the potential wealth effect is large; and if the change in demand for certain products is great enough to affect the price of those products, then a change in the liability rule may have an effect on the distribution of resources in the long run. Thus, transactions in the context of the Coase Theorem must be assumed to occur in the absence of wealth effects.

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104. Harold Demsetz, *The Cost of Transacting*, 82 Q.J. Econ. 33, 50 (1968).

105. *Id.*

106. Oliver E. Williamson, *Transaction-Cost Economics: The Governance of Contractual Relations*, 22 J.L. & Econ. 233, 261 (1979).

107. Posner, *Economic Analysis of Law*, *supra* note 4, at 51.

108. *See supra* notes 81–85 and accompanying text.

109. Coase, *supra* note 77, at 173.

4. Rationality

The premise that producers and consumers will strike mutually advantageous bargains if there are no transaction costs, crucial to the Coase Theorem, derives from the assumption that the parties are rational. One part of this assumption, basic to economic analysis, as Gary Becker has stated, is that "individuals maximize welfare *as they conceive it*, whether they be selfish, altruistic, loyal, spiteful, or masochistic."[110] Thus, parties will not ignore opportunities to increase their welfare by way of a bargain.

5. Property Rules, Liability Rules, and Inalienability

The distinctions among property rules, liability rules, and inalienability are more in the nature of definitions than assumptions. However, several of the arguments about and implications of the Coase Theorem require an understanding of these distinctions. This topic and how it relates to the Coase Theorem was first examined by Guido Calabresi and A. Douglas Melamed.[111] They divide the question of entitlement into two parts: first, which party receives the entitlement, and second, what form does it take.[112] The party that society decides to favor is the party that receives the entitlement.[113]

An entitlement is protected by a property rule if the entitlement can be purchased from the holder for a price the buyer and the seller agree upon in a voluntary transaction.[114] This method of protecting an entitlement requires the least amount of government involvement, because it is up to the parties to determine the entitlement's value. The seller may refuse any offer that is not high enough to meet the seller's own valuation.[115]

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110. Becker, *Nobel Lecture*, *supra* note 4, at 386; *see also* Jon Elsten, *More Than Enough*, 64 U. Chi. L. Rev. 749, 761 (1997) (book review) (stating that "*the concept of rationality is subjective through and through*").

111. Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 Harv. L. Rev. 1089 (1972).

112. *Id.* at 1090–92.

113. *Id.* at 1090.

114. *Id.* at 1092.

115. *Id.*

Examples of property protections include "restraining orders, specific performance clauses, and certain types of punitive sanctions."[116]

A liability rule means that the other party may destroy the entitlement if he or she is willing to compensate the entitlement-holder for it at some value set by the State or the courts.[117] Examples of liability protections include expectation damages, the Takings Clause of the Fifth Amendment,[118] and compulsory licenses.[119]

An entitlement is considered inalienable if it cannot be bought or sold even by voluntary participants.[120] For example, people are not allowed to sell themselves into slavery, certain types of pornography may not be sold, and various goods may not be sold to minors.[121]

Calabresi and Melamed point out that many entitlements are protected by more than one type of rule.[122] They cite a house as an example of an entitlement that is normally protected by a property rule in circumstances involving an ordinary sale, covered by a liability rule when it comes to government takings, and inalienable when a party to the transaction is incompetent.[123]

Each of these assumptions and definitions must be remembered when evaluating the Coase Theorem. Many of the criticisms and tests of the Coase Theorem are relevant only if the assumptions underlying the Coase Theorem are weakened or ignored. Weakening these assumptions may make the model under which these critics are working more reflective of the real world, but such attacks may be more a criticism of the divergence between the real world and the Coasean world than of the Coase Theorem itself.[124] This divergence is what prompts the need for a

116. Ian Ayres & Eric Talley, *Solomonic Bargaining: Dividing a Legal Entitlement to Facilitate Coasean Trade*, 104 Yale L.J. 1027, 1037 (1995).

117. Calabresi & Melamed, *supra* note 111, at 1092.

118. U.S. Const. amend. V.

119. Ayres & Talley, *supra* note 116, at 1037.

120. Calabresi & Melamed, *supra* note 111, at 1092.

121. *Id.* at 1112–13.

122. *Id.* at 1093.

123. *Id.*

124. It has been pointed out that "the Coasean world" is not an appropriate title to give to the world in which the assumptions underlying the Coase Theorem are true, since "[t]he 'Coasean world' is not only not Coase's world but, ironically, is more like the world of the economic theoretists that Coase has attacked." Robert C. Ellickson, *The Case for Coase and Against Coaseanism*, 99 Yale L.J. 611, 611 (1989). However, the phrase is a convenient appellation to give to the world described by the Coase Theorem and is often so used.

more realistic model. Coase has never claimed that the Coase Theorem describes what would happen in the real world; in fact, he has argued very strenuously that it does not reflect the real world at all.[125]

It is also important to keep these assumptions in mind when evaluating the validity of implications that have been drawn from the Coase Theorem. If policy prescriptions depend too heavily on Coasean assumptions being true, then they may not be appropriate in the many circumstances in which the assumptions do not hold true.

C. *Policy Implications of the Coase Theorem*

1. *Moving from the Hypothetical Coasean World to the Real World*

While the Coase Theorem is informative in the abstract, its assumptions make the world in which the theorem operates far different from the real one, as Coase himself acknowledges.[126] In the hypothetical realm of no transaction costs, the Coase Theorem implies that the assignment of rights would not be important in terms of economic efficiency, because, regardless of which party received an entitlement, the parties would bargain to achieve the Pareto optimal allocation of resources.[127] But bargaining is not costless, and information is not perfect. Wealth effects do exist, and not all markets are perfectly competitive. Thus, in the real world, any chosen legal rule has an effect on the allocation of resources.[128] As Coase suggested, the introduction of "positive transaction costs" is required to analyze real-world events.[129]

In *The Problem of Social Cost*, Coase was not arguing for a particular policy prescription. Rather, he was arguing against the idea that external effects always require government intervention. He noted that "[a]ll solutions have costs and there is no reason to suppose that government regulation is called for simply because the problem is not well handled by the market or the firm."[130] Rather than making a change because the situation in the real world is different than it would be in an ideal world,

125. Coase, *supra* note 59, at 15.

126. *Id.*

127. *See supra* notes 81–85 and accompanying text.

128. Coase, *supra* note 77, at 175; Posner, *Economic Analysis of Law*, *supra* note 4, at 52; Cento G. Veljanovski, *The Coase Theorem—The Says Law of Welfare Economics?*, 53 Econ. Rec. 535, 539 (1977).

129. Coase, *supra* note 59, at 15.

130. Coase, *Social Cost*, *supra* note 4, at 18.

Coase advocated comparing the effects that different solutions would have in the real world and choosing the solution that would maximize total welfare. He wrote:

> [I]n choosing between social arrangements within the context of which individual decisions are made, we have to bear in mind that a change in the existing system which will lead to an improvement in some decisions may well lead to a worsening of others. Furthermore we have to take into account the costs involved in operating the various social arrangements (whether it be the working of a market or of a government department), as well as the costs involved in moving to a new system. In devising and choosing between social arrangements we should have regard for the total effect.[131]

Thus, Coase was not advocating a particular policy, but a particular method of determining policy. While the Coase Theorem has been very influential, Coase's argument that policy analysis should involve comparing the real-world effects of various potential policies is a critically important insight. Despite this aim, the Coasean method has been used by a number of law and economics scholars to suggest policies for specific situations.

2. *The Role of Negotiation in Rulemaking*

An important consideration in comparing different policy rules is to remember the role that negotiation can play in changing a rule. Although private negotiation cannot solve all allocation problems with transaction costs, its existence should not be ignored, and the possibility of correcting problems in this way should be considered in comparing different systems. As Joseph Farrell observes, "One institution may nicely solve problems that would in any case easily be negotiated away, but leave gaping holes that negotiation cannot plug; another may do badly on many problems, but they may be problems that negotiation can readily solve."[132] For this reason, Farrell suggests that "a *two-stage* evaluation of institutions" is required.[133] We should first examine the "outcomes the institution by itself will yield," and then, "before

131. *Id.* at 44.

132. Farrell, *supra* note 80, at 125.

133. *Id.*

evaluating its overall efficiency, ask how far its problems will be repaired by negotiation."[134]

3. *Indications for Market-Based Policies*

In considering the level of transaction costs, it should be noted that there are certain circumstances in which the best solution might be to allow the market to solve the problem. Transaction costs may be so low that bargaining is likely to reach a more efficient result than the government or the courts would. George Daly indicates that this may be the case when "(a) the number of parties involved in the externality is small, and (b) competition prevails in that market."[135] Joseph Farrell also states that private negotiation may be better than a government-imposed solution when (a) private information exists; (b) the government is unable to effectively use that information; (c) artificial barriers do not exist to block voluntary private contracts; and (d) the negotiating parties are few and easily identified.[136] Farrell cautions, however, that the presence of private information may still prevent the market solution from being the best solution.[137]

4. *Reduction of Transaction Costs*

One policy that may be appropriate in circumstances in which transaction costs are high is reduction of transaction costs where possible.[138] Transaction costs are likely to be higher when there is a great deal of uncertainty, when exchanges in a good are infrequent, when trading is decentralized, and when products are not standardized.[139] For

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134. *Id.*

135. George Daly, *The Coase Theorem: Assumptions, Applications, and Ambiguities*, 12 Econ. Inquiry 203, 208–09 (1974). Another approach to the situation in which transaction costs are low is that taken by Stewart Schwab. *See* Stewart Schwab, *Coase Defends Coase: Why Lawyers Listen and Economists Do Not*, 87 Mich. L. Rev. 1171, 1195 (1989) (reviewing Coase, *The Firm, the Market, and the Law*, *supra* note 4). Schwab points out that if transaction costs are low, "The law has no reason to award entitlements to those willing and able to pay the most for it because, under zero transaction costs, the needy or deserving holders of the entitlement can trade it without any efficiency loss to those willing and able to pay more." *Id.* Schwab restates this as what he calls "*The Distributive Corollary of the Coase Theorem*: With zero transaction costs, initial entitlements cannot be justified on efficiency grounds, and so should be awarded on the basis of need or desert." *Id.*

136. Farrell, *supra* note 80, at 124.

137. *Id.*

138. Craswell, *supra* note 38, at 633.

139. *See supra* notes 104–06 and accompanying text.

example, since transaction costs are lower when there is greater certainty, an appropriate policy might be for courts to "concern themselves not so much with the substance of the legal rule as with its certainty and predictability."[140]

A related policy consideration is the existence of private information. Ian Ayres and Eric Talley suggest that a divided entitlement protected by a liability rule may reduce high transaction costs if the reason that they are high is the existence of private information.[141] They say that "[p]rivate information is a particularly pernicious form of transaction cost, especially in legal contexts where, for procedural or other reasons, parties must negotiate within 'thin' markets."[142] Where there is private information, parties have an incentive to bargain strategically and deceive the other party as to the goods' true valuations in order to gain a greater proportion of the bargaining surplus.[143] Ayres and Talley argue:

> [E]ndowing each bargainer with a share of the underlying entitlement creates the possibility of two different types of Coasean trade: A bargainer might buy the other party's claim, or alternatively, she might sell her own. During negotiation, each party is likely to be uncertain about whether she will ultimately emerge as a seller or a buyer.[144]

A rule of this type is often used in partnership agreements, which typically have provisions that if one partner wishes to dissolve the partnership, that partner must "name a firm value and then let the other owner choose whether to buy . . . or sell."[145] Because that partner does not know if he or she will be buying or selling, there is motivation to reveal private information, that is, what the firm is worth to him or her. Ayres and Talley recommend a rule of this sort when transaction costs are high due to private information, as a way to reduce those costs.[146]

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140. Craswell, *supra* note 38, at 632.

141. Ayres & Talley, *supra* note 116, at 1029–30.

142. *Id.* at 1030.

143. *Id.*

144. *Id.*

145. *Id.* at 1072.

146. *See id.*

5. *Assignment to the Party Having the Lowest Transactional Costs*

In certain instances, transaction costs may not be symmetrical. This means that one party may more easily change an inefficient rule than another.[147] Both E.J. Mishan and Alan Randall argue that pollution-related externalities are likely to have this characteristic, and that in such a case the appropriate policy is probably to make the polluter liable.[148]

> [Because] transaction costs are likely to be larger when negotiations must be initiated by a large and diffuse group of individuals rather than by a much smaller group of individuals who are more vitally interested in this particular issue, it follows that in cases of pollution from industrial sources, [a no liability] rule is more likely than is the [full liability] rule to result in transaction costs too high for the achievement of a solution other than the status quo.[149]

For this reason, Randall argues that a full-liability rule will be more likely to increase social welfare than a no-liability rule.[150]

6. *Assignment to the Party Most Valuing the Right*

In some cases, the appropriate policy may be for the law to allocate rights or duties as the parties most often would themselves if they could negotiate without transaction costs.[151] This reduces transaction costs because, for all of the parties for which that allocation is optimal, this policy eliminates the need for negotiation on that issue.[152] Even more important is the fact that:

> [I]f the parties are simply unable to negotiate—say because the costs of negotiating are prohibitively high, or because strategic posturing prevents them from reaching an agreement—then the only way to reach an efficient outcome is for the legal rule to

147. Calabresi & Melamed, *supra* note 111, at 1119; Mishan, *supra* note 101, at 23.

148. Mishan, *supra* note 101, at 23; Alan Randall, *Market Solutions to Externality Problems: Theory and Practice*, 54 Am. J. Agric. Econ. 175, 178 (1972).

149. Randall, *supra* note 148, at 178.

150. *Id.*

151. Craswell, *supra* note 38, at 633; Posner, *Economic Analysis of Law*, *supra* note 4, at 93.

152. Craswell, *supra* note 38, at 633.

> supply the remedy to which the parties would have negotiated had they been able.[153]

In many situations, according to Richard Craswell, the adoption of this policy will maximize total welfare.[154]

7. *Property Rules Versus Liability Rules*

Another important policy decision, and one that has generated much discussion in legal and economic literature, is when a rule should take the form of a property rule and when it should take the form of a liability rule.[155] Property rules require less government intervention, in that they do not require the government to place a possibly inaccurate valuation on an entitlement. At the same time, because the price is already set with liability rules, property rules may reduce the need for negotiating and thus reduce transaction costs.

Calabresi and Melamed argue that the most efficient rule when transaction costs are low is a property rule.[156] They point out that this is true even when it is not clear that the entitlement chosen is the efficient one, since the parties can easily bargain to correct any error.[157] In that case, they add, "While the entitlement might have important distributional effects, it will not substantially undercut economic efficiency."[158]

When transaction costs are high, however, a liability rule may be a more efficient solution than a property rule.[159] Richard Posner writes about pollution rights:

> In the presence of high transaction costs, absolute (i.e., unqualified) rights, whether to pollute or to be free of pollution, are likely to be inefficient. The factory that has the absolute right to pollute will, if transaction costs are prohibitive, have no incentive to stop (or reduce) pollution even if the cost of stopping would be much less than the cost of pollution to the homeowners. Conversely,

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153. *Id.*

154. *Id.*

155. *See supra* Part II.B.5 (discussing distinctions between liability and property rules).

156. Calabresi & Melamed, *supra* note 111, at 1118.

157. *Id.*

158. *Id.*

159. Posner, *Economic Analysis of Law*, *supra* note 4, at 63; Calabresi & Melamed, *supra* note 111, at 1107; Harold Demsetz, *When Does the Rule of Liability Matter?*, 1 J. Legal Stud. 13, 26–27 (1972).

> homeowners who have an absolute right to be free from pollution will, if transaction costs are again prohibitive, have no incentive to take steps of their own to reduce the effects of pollution even if the cost to them of doing so (perhaps by moving away) is less than the cost to the factory of not polluting or of polluting less.[160]

These concerns are particularly likely to be important when there are free-rider or holdout problems, as is likely to be the case in a context in which there are many parties on at least one side.[161]

D. Critiques of the Coase Theorem

The Coase Theorem has been the focus of some of the most spirited debate in both legal and economic literature. Opponents of the Coase Theorem have suggested that it is invalid because it does not hold true in the long run,[162] it does not take account of risk,[163] it depends on the existence of economic rents to be true,[164] it depends on the convexity of the production function,[165] it does not take account of the possibility of strategic behavior,[166] it does not truly reflect consumer behavior,[167] and it

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160. Posner, *Economic Analysis of Law*, *supra* note 4, at 63.

161. Calabresi & Melamed, *supra* note 111, at 1106–07; Posner, *Economic Analysis of Law*, *supra* note 4, at 62–63.

162. *See, e.g.*, Guido Calabresi, *The Decision for Accidents: An Approach to Nonfault Allocation of Costs*, 78 Harv. L. Rev. 713 (1965); Donald H. Regan, *The Problem of Social Cost Revisited*, 15 J.L. & Econ. 427 (1972); William Schulze & Ralph C. D'Arge, *The Coase Proposition, Information Constraints, and Long-Run Equilibrium*, 64 Am. Econ. Rev. 763 (1974). Calabresi later rethought his position and argued that the liability rule would not, after all, affect the long-run allocation of resources. Guido Calabresi, *supra* note 102, at 67.

163. Posin, *supra* note 76, at 832–44. Posin also attempted to disprove the Coase Theorem in a previous article: Daniel Q. Posin, *The Coase Theorem: If Pigs Could Fly*, 37 Wayne L. Rev. 89 (1990). That article was widely criticized, and Posin himself later admitted that it was wrong because it failed to consider opportunity cost. Posin, *supra* note 76, at 799–801.

164. Regan, *supra* note 162, at 433; David L. Shapiro, *A Note on Rent and the Coase Theorem*, 7 J. Econ. Theory 125 (1974); Stanislaw Wellisz, *On External Diseconomies and the Government-Assisted Invisible Hand*, 31 Economica 345, 351 (1964). The economic rent that an activity creates "consists of the difference between what a factor of production earns in a given activity and what it could earn in the best alternative activity." Coase, *supra* note 77, at 165.

165. *See, e.g.*, A. Mitchell Polinsky, *Economic Analysis As a Potentially Defective Product: A Buyer's Guide to Posner's* Economic Analysis of Law, 87 Harv. L. Rev. 1655, 1675–76 (1974); David A. Starrett, *Fundamental Non-Convexities in the Theory of Externalities*, 4 J. Econ. Theory 180 (1972); Kenneth R. Vogel, *The Coase Theorem and California Animal Trespass Law*, 16 J. Legal Stud. 149, 154–60 (1987).

166. *See* Regan, *supra* note 162, at 429–30.

raises the possibility of extortion.[168] Meanwhile, Coase's defenders have responded to these articles by pointing out the weaknesses in the critiques and the ways in which they misstate or misunderstand the Coase Theorem.[169]

Among the most convincing criticisms of the validity of the Coase Theorem is that put forth by proponents of construction theory,[170] among others, that the assumption of rationality does not accurately describe how consumers actually behave. Cass R. Sunstein points out that in actuality, the decisions that people make are strongly influenced by social norms.[171] Norms, he notes, are "social attitudes of approval and disapproval, specifying what ought to be done and what ought not to be done."[172] It is claimed that social norms better predict the actions of market participants than assumptions about rationality do. For example, "people contribute to a shared good, and refuse to free ride, far more

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167. Mark Kelman, *Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 52 S. Cal. L. Rev. 669, 678–95 (1979).

168. *See, e.g.*, George Daly & J. Fred Giertz, *Externalities, Extortion, and Efficiency*, 65 Am. Econ. Rev. 997 (1975).

169. *See, e.g.*, Ronald H. Coase, *The 1987 McCorkle Lecture: Blackmail*, 74 Va. L. Rev. 655, 671 (1988); Robert D. Cooter, *How the Law Circumvents Starrett's Nonconvexity*, 22 J. Econ. Theory 499 (1980); Demsetz, *supra* note 159, at 19; Hovenkamp, *supra* note 89, at 789–93; Steven G. Medema, *Through a Glass Darkly or Just Wearing Dark Glasses? Posin, Coase, and the Coase Theorem*, 62 Tenn. L. Rev. 1041 (1995); G. Warren Nutter, *The Coase Theorem on Social Cost: A Footnote*, 11 J.L. & Econ. 503 (1968); Matthew Spitzer & Elizabeth Hoffman, *A Reply to Consumption Theory, Production Theory, and Ideology in the Coase Theorem*, 53 S. Cal. L. Rev. 1187 (1980); Zerbe, *supra* note 78, at 89.

170. Construction theory concerns the ways that social meanings are constructed and changed. *See, e.g.*, Lawrence Lessig, *The Regulation of Social Meaning*, 62 U. Chi. L. Rev. 943, 949–51 (1995). According to this school of thought, "Human reality is not provided at birth by the physical universe, but rather must be fashioned by individuals out of the culture into which they are born." *Id.* at 949 n.19 (quoting David Kertner, *Ritual, Politics, and Power* 3–4 (1988)); *see also* Peter L. Berger & Thomas Luckmann, *The Social Construction of Reality: A Treatise in the Sociology of Knowledge* (1966); Jon Elster, *The Cement of Society: A Study of Social Order* (1989); Symposium, *Law, Economics, & Norms*, 144 U. Pa. L. Rev. 1643 (1996).

171. *See* Sunstein, *Social Norms*, *supra* note 9, at 945 (noting that "[w]hen people appear to behave irrationally, in the sense that they violate predictions based on economic assumptions, it is often because social norms are at work").

172. *Id.* at 914. Sunstein points out:

> [T]here are socials norms about nearly every aspect of human behavior. There are norms about littering, dating, smoking, singing, when to stand, when to sit, when to show anger, when, how, and with whom to express affection, when to talk, when to listen, when to discuss personal matters, when to use contractions, when (and with respect to what) to purchase insurance.

Id. "The persistent urge to conform to social norms has been demonstrated in a good deal of work in social psychology." *Id.* at 915 n.41.

often than economists predict."[173] Another example of this is the "endowment effect," that is, the fact that "[t]he initial grant of an entitlement of some good *X* to some person *A* can make *A* value *X* far more than he would if *X* had been initially allocated to *B*."[174] Similarly, people may insist that they be paid more to give up a right than they are willing to pay to prevent the loss.[175] Social norms regarding the perceived "fairness of bargains" have also been demonstrated to weaken the presumption of rational self-maximizing bargaining. We discuss this "fairness effect" in Part IV.B below.

For the most part, the literature described above attacks perceived weaknesses in the Coase Theorem's assumptions and theoretical structure. However, there also exists literature criticizing the Coase Theorem and the law and economics movement in general on grounds that have nothing to do with the theorem's theoretical correctness. The Coase Theorem has been attacked from both the left and the right on moral and equitable grounds. One of the harshest criticisms has been that the Coase Theorem places efficiency above other values that are equally if not more important.[176]

Charles Fried criticizes Coasean reasoning—or what he calls the economic analysis of rights—for removing the consideration of moral and distributional objectives from the determination of rights.[177] Fried points out that the economic analysis of rights uses a concept of efficiency that is removed from distributional questions.[178] He argues that while economic analysis may tell us what is an efficient allocation of resources, it does not consider whether that distribution is fair or just.[179] The outcome of a Coasean analysis depends, Fried says, on the "initial endowments and assignments of rights; that is, it is a function of the

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173. *Id.* at 945.

174. *Id.* at 942.

175. Cass R. Sunstein, *Free Markets and Social Justice* 249 (1997). For example, "[o]ne study found that people would demand about five times as much to allow destruction of trees in a park as they would pay to prevent the destruction of those same trees." *Id.*

176. *See, e.g.*, Charles Fried, *Right and Wrong* 81–107 (1978); Duncan Kennedy, *Cost-Benefit Analysis of Entitlement Problems: A Critique*, 33 Stan. L. Rev. 387 (1981); Laurence H. Tribe, *Technology Assessment and the Fourth Discontinuity: The Limits of Instrumental Rationality*, 46 S. Cal. L. Rev. 617 (1973).

177. *See* Fried, *supra* note 176, at 81–107.

178. *Id.* at 93.

179. *See id.* at 94.

distribution with which the bargaining parties begin."[180] The fact that a given outcome is efficient, Fried states, should not give it "any privileged claim to our approbation."[181] While "the attainment of efficiency," unlike the achievement of distributional justice, may "have the virtue of offering a clear and unambiguous criterion of social policy," that is not reason enough to make efficiency *the* criterion for social policy.[182]

Fried believes that economic analysis comes down to the notion that "[e]fficiency is one thing, distribution another."[183] He calls this approach "the sundering of ethical decisions from decisions about rights."[184] He contends that the removal of ethical and moral considerations from our review of entitlements results in the view that the allocation of our rights depends on the efficiency that results.[185] Under this view, "[r]ights cannot be thought of as expressive of the moral position which one has in entering into bargains or relations with others."[186] This contradicts, Fried says, "the nonconsequentialist, categorical conception of rights."[187] The economic analysis of rights, Fried believes, suffers the same problem that all utilitarian forms of analysis share, to wit:

> [It] offers no way of giving substantive content to the concept of the person, all characteristics being available for adjustment as the optimific calculus might dictate, all attributes of the person being contingent. The person finally becomes an abstract point, to which pleasure and pain may be attributed, but with no dimension or shape of its own.[188]

In Fried's view, this vision of rights as secondary, or as a means to the goal of efficiency, is "the very opposite of the theory of rights that we want."[189] Fried argues for a conception of rights as "elaborated from the concept of the person and what is necessary to establish the integrity of the person."[190]

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180. *Id.* at 93.
181. *Id.* at 93–94.
182. *Id.* at 94.
183. *Id.* at 96.
184. *Id.*
185. *Id.*
186. *Id.*
187. *Id.* at 97.
188. *Id.* at 104.
189. *Id.*
190. *Id.* at 105.

Duncan Kennedy also raises normative objections to the use of Coasean reasoning to solve legal problems.[191] First, he argues that the application of cost-benefit analysis to real-world problems implicitly requires the analyst to make normative decisions.[192] He states that if economic analysis is to determine the "ideal private law," we will have to make value judgments that are "more controversial, because more overtly political," than simply saying that we should make changes whose benefits to the gainers exceed costs to the losers.[193] He adds that, under the Coasean model, "We try to imagine how the process of bargaining over resource use would have come out, if there had been no transaction costs, assuming that everyone exercised their rights under existing law. Then we modify the existing set of entitlements to replicate that result."[194] The problem with this approach, he argues, is that it "skew[s] the efficiency calculus as far as possible toward maintaining the existing order of things."[195]

Another critic, Laurence Tribe, argues that economic analysis is not appropriate in the political context, because political decisionmaking should give weight to moral and ethical considerations.[196] A weakness Tribe sees with economic analysis as a method of setting policy is that it considers what people's preferences are, but it does not consider what their preferences "should be."[197] Tribe uses the example of a community that must determine whether to build a dam that will have economic benefits, but will destroy wilderness areas and perhaps species of birds and animals.[198] Tribe suggests that using economic analysis to determine whether to build the dam might help the community determine "how much its inhabitants *do in fact* value birds and other wildlife as compared . . . with boating and other activities."[199] However, economic analysis "could *not* enable the community's inhabitants to think about *what the value systems ought to be*—about the extent to which theirs

191. Kennedy, *supra* note 176.

192. *See id.* at 388.

193. *Id.*

194. *Id.* at 415.

195. *Id.* at 419.

196. *See* Tribe, *supra* note 176, at 655–60.

197. *Id.* at 656.

198. *Id.* at 655.

199. *Id.* at 656.

should be a wildlife-valuing community."[200] Tribe does not suggest that economic analysis should be abandoned, but only that "it should always be enriched by attempts" to consider the substance of rights as well.[201]

Despite these criticisms, there can be little doubt that the Coase Theorem provides us with a superb analytical tool that can demonstrate how bargains can be made efficient and how rights, liabilities, and entitlements can be allocated toward that end. The weakness of the Coase Theorem comes not from the assumptions that it requires—these are a necessary part of any economic model—but from the lack of understanding what these assumptions mean. Both attackers and defenders of the Coase Theorem must keep in mind that the Coasean world is not the real world, and that there are real-world effects of which the Coase Theorem does not take account. Although the Coase Theorem can tell us what is efficient, it alone cannot determine if what is efficient will also be fair.

III. JUSTICE AS FAIRNESS

In contrast to the late-twentieth-century emphasis on justice as efficiency by certain theorists, justice as fairness has been a theme of the common law from its earliest times through the present.[202] Equality-seeking and redistributive principles of justice, although of ancient origin, are always undergoing new packaging. At times, notions of justice have centered primarily on form and process, on dispensing justice "according to the rules."[203] More recently, the focus on fairness has included a greater emphasis on substantive notions and on a perceived need to use the law for redressing and adjusting inequalities of both the opportunities for seeking society's scarce resources and the resulting allocation of those resources.[204] It may be the ultimate reductionism to claim that the reams of commentaries proclaiming justice as equality and fairness come down to the ancient maxim: what you

200. *Id.*

201. *Id.* at 659.

202. Charles M. Haar & Daniel William Fessler, *The Wrong Side of the Tracks: A Revolutionary Rediscovery of the Common Law Tradition of Fairness in the Struggle Against Inequality* 15 (1986).

203. Jerold S. Auerbach, *Justice Without Law?* 143 (1983).

204. *See, e.g.*, H. Haywood Burns, *Law and Race in America*, in *The Politics of Law*, *supra* note 5, at 89; Nadine Taub & Elizabeth M. Schneider, *Perspectives on Women's Subordination and the Rule of Law*, in *The Politics of Law*, *supra* note 5, at 117.

would not have done to you, do not do to others.[205] In other words, do not treat me differently or with less respect because of my gender, race, age, national origin, appearance, physical or mental condition, or other economic and social conditions—or, to invert this ethical proscription into a positive command, do for me what you would have me do for you. From this edict it follows that one *should* care for others, especially those in need.

A. An Ethic of Care

How a person conceptualizes the bases of obligations goes a long way in explaining that person's view of justice.[206] In recent years, a growing, predominantly feminist literature has advanced the notion that caring about the needs of others is a strong normative basis for legal obligations.[207] Psychologist Carol Gilligan has argued that women tend to have more of a "care perspective" than men, who tend to conceptualize obligations in terms of substantive rights and duties and procedural impartiality.[208] She labeled the latter orientation the "justice perspective," which alternatively is referred to as the "rights" orientation.[209]

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205. *See Matthew* 7:12 (King James) (citing Jesus as stating that "all things whatsoever you would that men should do to you, do you even so to them"); *Luke* 6:31 (King James) (quoting Jesus as stating that "as ye would that men should do to you, do ye also to them likewise"). Twenty years before Jesus, Rabbi Hillel put the same proposition in the negative. 7 *The Interpreter's Bible* 329 (1951). Some earlier Latin translations of the Bible also cast Jesus' version of this so-called "Golden Rule" in the negative. Hobbes, *Leviathan*, *supra* note 41, at 110. The Golden Rule has been taught in positive or negative form by Lao-tzu, Confucius, and Plato. 7 *The Interpreter's Bible*, *supra*, at 329.

206. Compare Kant's categorical imperative that justice requires the keeping of promises because one must only act by those rules that one could will to become universal law," *see* S. Körner, *Kant* 136–37 (1955), with the law and economics' efficient-breach-of-contract thesis, which sanctions the failure to keep promises when the Pareto-efficient result would occur consequent to a breach, as explained in Posner, *Economic Analysis of Law*, *supra* note 4, at 118–20; *see also* Polinsky, *supra* note 4, at 31–38.

207. The current literature on empathy finds its modern emphasis especially in the writings of psychologist Carol Gilligan. *See, e.g.*, Gilligan, *supra* note 8. In *In a Different Voice*, Gilligan argues that women, more than men, see obligations as emerging from the needs of others rather than from imposed notions of impartial procedures and substantive rights. *Id.* at 5–23; *see also* Joyce E. McConnell, *Relational and Liberal Feminism: The "Ethic of Care," Fetal Personhood and Autonomy*, 99 W. Va. L. Rev. 291 (1996).

208. Carol Gilligan, *Moral Orientation and Moral Development*, in *Women and Moral Theory* 19 (Eva Feder Kittay & Diana T. Meyers eds., 1987). Gilligan argues that both justice (defined as a male orientation) and care (a female orientation) are significant:

> Theoretically, the distinction between justice and care cuts across the familiar divisions between thinking and feeling, egoism and altruism, theoretical and practical reasoning. It calls attention to the fact that all human relationships, public and private, can be characterized *both* in terms of

Also focusing on an obligation of care, Judith Areen has observed that a caring orientation involves several facets.[210] First, a person responding to another in need must be caring without being either demeaning or paternalistic.[211] Second, the caretaker, to be capable of caring for others, must take care of himself or herself.[212] Third, family or relational caring does not have a clear starting or ending time.[213] More significantly, Areen suggests that an ethic of care is a foundational basis for societal as well as personal obligations.[214] Despite being critiqued as sentimental, she contends that an ethic of care may be "not merely a virtue, but a source of principles" for law and justice.[215] For example, in suggesting how society and its laws ought to respond to the AIDS epidemic, Areen argues that an ethic of care requires society to take on specific obligations toward its victims.[216] Thus, caring goes beyond a purely subjective and discretionary response; it is obligatory in nature.

Areen points out that an ethic of care is not to be confused with sentiment, pity, or compassion. Rather, it is to be conceptualized as "the central virtue for sustaining human relationships and communities."[217] Care is, in essence, a strong source of the social obligation one person owes all others in the community. Areen notes that care is essential because it makes possible the building of key social relationships,

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equality and in terms of attachment, and that both inequality and detachment constitute grounds for moral concern. Since everyone is vulnerable both to oppression and to abandonment, two moral visions—one of justice and one of care—recur in human experience. The moral injunctions, not to act unfairly to others, and not to turn away from someone in need, capture these different concerns.

Id. at 20.

In response to Gilligan, Judith Areen has written that the potential incompatibility between a caring or empathetic perspective and the traditional rights-oriented perspective "is an ancient theme," citing Sophocles's dialogue as an example. Areen, *supra* note 23, at 1076–77. Margaret Jane Radin has opined that a "feminist middle way" would incline human beings both to be caring and to seek justice. Radin, *supra* note 8, at 1718.

209. Gilligan, *supra* note 208, at 20–24.

210. Areen, *supra* note 23, at 1075.

211. *Id.*

212. *Id.*

213. *Id.*

214. *Id.* at 1076.

215. *Id.*

216. *Id.* at 1078–82.

217. *Id.* at 1076.

including those of families, households, and communities—be they neighborhoods or nations.[218]

The perceived irrationality of the justice-as-care thesis has been the topic of considerable debate. Certain critics argue that care is not so much a consequence of rational consideration as of subjective and intuitive feeling.[219] But some feminists, including Cynthia Ward, have suggested that feeling and imagination are aspects of *reason* and *understanding*.[220] This is a critical insight, for it argues that a caring disposition includes the assimilation of another dimension of knowledge that can be rationally used in decisional contexts.

B. Fairness as Empathy

If society were governed only by an ethic-of-care principle for determining the "justice" of legal rules and entitlements, any form of governance could result.[221] Indeed, a government might attempt to control the marketplace completely by deciding what goods and services are to be produced, what the prices will be, who is eligible for receiving these resources, and in what amounts those will be allocated, all according to central planners' dictates. But history suggests that such controlled economies aspiring for the greater social good do not deliver what they initially promise. An ethic-of-care principle alone as the driving moral authority for a government's interference in the lives of its citizens fails to recognize the still valid, invisible hand of laissez-faire economics—people generally are better off overall when they are allowed to seek and maximize their preferences in an open marketplace,

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218. *Id.* (citing Alisdaire MacIntyre, *After Virtue: A Study in Moral Theology* (2d ed. 1984)).

219. Rational choice theorists criticize what is claimed to be the modern sociologist's view that people are "pawns of social forces." *See, e.g.*, Robert H. Frank, *The Strategic Role of the Emotions*, 5 Rationality & Soc'y 160 (1993) (responding to James Coleman's 1990 book, *Foundations of Social Theory*).

220. "[T]he understanding gained through projective empathy is *both* rational and emotional." Cynthia V. Ward, *A Kinder, Gentler Liberalism? Visions of Empathy in Feminist and Communitarian Literature*, 61 U. Chi. L. Rev. 929, 938 (1994) (emphasis added); *see also* Henderson, *supra* note 29, at 1576 ("Empathy is a form of understanding, a phenomenon that encompasses affect as well as cognition .... [It is not] 'intuition.'").

221. Richard Posner has suggested that a theory of distributive justice based on maximizing the benefits for the worst-off members of society would be "compatible with on the one hand out-and-out socialism and on the other hand *laissez-faire* capitalism." Posner, *Economic Analysis of Law*, *supra* note 4, at 462–63.

and governmental interference is confined to making the marketplace more efficient.[222]

An open, accessible marketplace allows citizens to imagine, create, produce, distribute, exchange, and share scarce resources in such a manner that everyone should be better off in the end. After all, it takes profits to pay taxes that pay benefits and provide services, such as medical care, for those unable to pay for them. The very success of free markets and constrained capitalism allows for a modified redistributive welfare state. But free markets without redistributive features lead to growing income and resource disparities.

What is true about macroeconomics is also true about micro-economics. The key question becomes how to synthesize two themes of justice: wealth maximization through permitting and emulating efficient exchanges, and maintenance of a "fair" net increase in utility for each party so as to prevent disproportionate gains by the stronger marketplace participants. Such a synthesis requires a meaningful definition of "fair." But how do we determine what fairness means? One way is to isolate and focus on a key aspect of the ethic of care, the human capacity for reasoned empathy.

Lynne N. Henderson has become a leading theorist for integrating what she purposefully calls "empathy" (rather than care) into the law. She acknowledges that empathy is a mix of rational with irrational elements.[223] On the emotional side, one's empathetic thought process, she has written, includes a distress response that may (but not must) cause one to take action to ease the pain of another.[224]

Empathy's relationship to rationality is more complex.[225] Susan Bandes has noted that empathy is an instrumental concept—"not an emotion . . . but rather a capacity, a tool used to achieve a variety of ends."[226] Empathy is not limited to one's emotional response to

222. Adam Smith, *The Wealth of Nations* (Kathryn Sutherland ed., Oxford Univ. Press 1993) (1776).

223. Henderson, *supra* note 29, at 1579.

224. Lynne Henderson, *The Dialogue of Heart and Head*, 10 Cardozo L. Rev. 123, 132 (1988).

225. Among several able attempts to define empathy as it relates to law are: Areen, *supra* note 23; Susan Bandes, *Empathy, Narrative, and Victim Impact Statements*, 63 U. Chi. L. Rev. 361 (1996); Henderson, *supra* note 29, at 1578–87; Toni M. Massaro, *Empathy, Legal Storytelling, and the Rule of Law: New Words, Old Wounds*, 87 Mich. L. Rev. 2099 (1989); Okin, *supra* note 19; Ward, *supra* note 220.

226. Bandes, *supra* note 225, at 379. Bandes quotes from the literature of psychoanalysis to describe empathy as being primarily a value-free, mental capacity to understand the position of

something; rather, it is the rational intellectual capability and resulting phenomenon of understanding a situation from another's vantage point. Thus, a comment such as "I understand where you're coming from" is an acknowledgment of the utterer's mental capacity to consider the situation from another's perspective. To empathize is the mental process of coming to understand another's experience "from the other person's point of view, projecting oneself into the other's place as subject of her experience."[227] Projective empathy, Cynthia V. Ward points out, is inescapably self-focused, as one projects oneself into another's place as subject.[228]

In her article *Legality and Empathy*, Henderson discusses the role of empathy as it relates to law.[229] She claims that empathetic narrative "is part of legal discourse," and that "empathetic understanding can play a role in legal decision making."[230] Among the cases Henderson cites to support her thesis are *Brown v. Board of Education*[231] and *Roe v. Wade*.[232] On the other hand, Henderson observes, legal decisions frequently have "nothing to do with understanding human experiences"[233] or with the circumstances under which many people actually live.[234]

Henderson contends that judges and other legal decisionmakers will be aided by gaining an empathetic understanding of the parties affected by a given dispute.[235] Possessing this mental disposition, a judge is more likely to discover and be responsive to the possible impacts an outcome

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another, including that person's emotions. *Id.* at 373 n.51, 380 (citing in support Michael Franz Basch, *Empathetic Understanding: A Review of the Concept and Some Theoretical Considerations*, 31 J. Am. Psychoanalytic Ass'n 101, 119 (1983)).

227. Ward, *supra* note 220, at 934 (citing David Woodruff Smith, *The Circle of Acquaintance: Perception, Consciousness, and Empathy* 112 (1989)).

228. *Id.*

229. Henderson, *supra* note 29.

230. *Id.* at 1649.

231. 347 U.S. 483 (1954).

232. 410 U.S. 113 (1973).

233. Henderson, *supra* note 29, at 1574. "[T]he Court [in *Roe v. Wade* and in *Doe v. Bolton*] has arguably failed to see the pain, despair, and stigma of women with 'unwanted' pregnancies and 'unwanted' children." *Id.* at 1620. "Stories can shock them [academics, judges, and lawyers] back into sensation, into life as it *is* versus how we talk about it." Massaro, *supra* note 225, at 2105.

234. Henderson, *supra* note 29, at 1574–75.

235. *Id.* at 1576. Henderson notes that the U.S. Supreme Court's decision in *Brown v. Board of Education* "came from an understanding that segregation, no matter how it is rationalized, caused human beings pain." *Id.* at 1650.

of the dispute may have on the parties' human (including emotional and psychic) situations. In this sense, empathy can be considered an added dimension to one's knowledge, permitting a more contextual understanding of a given situation and of the alternative responses to it.[236]

Henderson can be read as suggesting that emotions of compassion, sympathy, or pity should become strong factors in legal decisionmaking. Emotional responses can be irrational and in many cases non-quantifiable.[237] But an empathetic understanding of a situation, which takes into account the entire range of impacts a decision can affect, may, in many instances, be a strong decisional factor.[238] Henderson demonstrates her thesis by analyzing four well-known U.S. Supreme Court cases[239] in which, she argues, the decisional processes involved the Court's gaining or failing to gain empathetic knowledge about how the affected parties themselves viewed their situations. In describing what she calls the "discovery" aspects of empathy, Henderson notes the phenomenon by which a decisionmaker learns information about others, including knowledge of how others perceive and think about themselves.[240]

One can witness this discovery process at work in real-world contract negotiations, where each side often learns about the concerns and problems the other party faces in performing its undertakings. In

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236. "[T]he ideological structures of legal discourse and cognition block affective and phenomenological argument: The 'normal' discourse of law disallows the language and emotion of experience." *Id.* at 1575. Henderson describes normal discourse about law as being "impoverished," lacking input of the full range of human experience. *Id.* at 1574–75.

237. Empathy, Henderson notes, essentially does not consist of one's emotional response to a situation, but rather the perception one obtains of the emotion or experience of another. *Id.* at 1651. However, anger, impatience, sympathy, rectitude, hatred, and love do act as psychological stimuli. *See* Jerome Frank, *Law and the Modern Mind* 108–26 (Anchor Books ed., Doubleday & Co., Inc. 1963) (1930). On the other hand, some argue that emotions should have minimal influence. See, for example, Ronald Dworkin's description of his mythical judge "Hercules" who decides cases by rationally applying principles of integrity. Dworkin, *supra* note 2, at 244–66.

238. A common expression may serve to highlight Henderson's point, at least as we understand it—the expression "how would I feel if I were you?" In commenting on empathy, Louis Wolcher has written: "It is much easier for us to inflict an injustice on others than it is for us to inflict an injustice on ourselves." Louis E. Wolcher, *What We Do Not Doubt: A Critical Legal Perspective*, 46 Hastings L.J. 1783, 1836 (1995).

239. Bowers v. Hardwick, 478 U.S. 186 (1986); Roe v. Wade, 410 U.S. 113 (1973); Shapiro v. Thompson, 394 U.S. 618 (1969); Brown v. Board of Educ., 347 U.S. 483 (1954).

240. Henderson defines the process of empathy phenomenologically as three possible and distinct situations: first, feeling the emotions of another; second, understanding the experience or situation of another, both affectively and cognitively; and third, the possible action that may result by experiencing the situation of another. Henderson, *supra* note 29, at 1579.

negotiating a building contract, for example, the parties may raise concerns about availability of needed supplies, labor, and materials, weather factors and delays, financing and escrow arrangements, bonding particularities, an architect's scope of duties, progress payment schedules, change-order procedures, and so on. Given each party's empathetic knowledge of the other's concerns and problems, negotiation becomes a bargaining-to-consensus procedure in which the final agreement is in part influenced and shaped by such knowledge. In this sense, negotiation and bargaining includes the process of each party trying to discover and understand the other party's circumstances and then accommodating those circumstances so that, in the final bargain, each still receives the perceived maximum attainable increase in marginal utility. Thus, it can be concluded that empathetic knowledge promotes the efficiency of bargained-for exchanges. Adam Smith noted that empathy allows one person to care about what happens to other people by imaginatively entering into their thoughts and feelings.[241] Indeed, empathetic knowledge is a routine component of the process of private autonomy for reaching efficient agreements where real bargaining is possible. But, as demonstrated below, the role of empathy has also been a strong component of social contract theories of justice.

C. The Social Contract

The notion of a "social contract" in the political sense suggests that individuals come together and agree to transfer a portion of their individual liberties into a social arrangement that will promote their mutual self-interest. A concept of normative political theory known as contractarianism traces its origins at least to Cicero and the Roman law.[242] With the publication of *Leviathan* in 1651, Thomas Hobbes, it has been claimed, advanced the idea of a social contract as the legitimating foundation for social control.[243] Later, John Locke, David Hume, Otto

241. Posner, *Economics of Justice*, *supra* note 4, at 122–23 n.7 (citing Adam Smith, *The Theory of Moral Sentiments* (reprint ed. 1969) (1759), and Ronald H. Coase, *Adam Smith's View of Man*, 19 J.L. & Econ. 529 (1976)).

242. According to Peter Laslett, the origins of social contract theory as well as natural law can be found in the Roman Stoicism of Cicero and in the system of Roman law. Peter Laslett, *The Social Contract*, in 7 *The Encyclopedia of Philosophy*, *supra* note 41, at 467. Laslett was a Cambridge University (Trinity College) don who authored several books on John Locke, Robert Filmer, and social contract theory. 1 *id.* at xxxiv.

243. Hobbes, *Leviathan*, *supra* note 41. Rawls, however, suggests that Hobbes may not have advanced a true social contract deriving from a consensus. *See* Rawls, *supra* note 19, at 11 n.4.

Gierke, and Jean-Jacques Rousseau, among others, each produced versions of contractarian theory.[244]

The social contract has been described as the core concept of the contractarian tradition.[245] The term relates to the normative, rationally-based tradition in political philosophy, which sets up models of social consensus. To generalize, the social contract results from an initial consensus reached by a collection of individuals who come together from a "state of nature,"[246] rationally agree on their society's basic institutional arrangement, and, under certain theories, on the fundamental principles by which the arrangement is to be conceived. The consensus necessitates an agreement involving the transfer of a portion of each individual's autonomous powers to a newly agreed-upon and subsequently set-up governmental arrangement. Contractarians tend to make various arguments, but in common they advocate the perceived wisdom of preserving individual liberties to the fullest extent compatible with the perceived necessity of mutual protection and self-preservation at any cost, the latter relating to Hobbes's law of paramount necessity.[247]

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244. *See* J.W. Gough, *The Social Contract* (2d ed. 1957); Locke, *Two Treatises*, *supra* note 42; C.B. Macpherson, *The Political Theory of Possessive Individualism: Hobbes to Locke* (1962); *Social Contract: Essays by Locke, Hume, and Rousseau* (Sir Ernest Barker ed., 1948); Howard Warrender, *The Political Philosophy of Hobbes: His Theory of Obligation* (1957).

Otto Gierke, a German, also has been a major contributor to social contract theory. *See* Otto Gierke, *Natural Law and the Theory of Society 1500–1800* (Ernest Barker trans., Cambridge Univ. Press 1934) (1913). Besides Immanuel Kant, another significant contractarian in the natural law tradition is Geoffrey Russell Grice, who authored *The Grounds of Moral Judgement* (1967).

245. "Social contract is the name given to a group of related and overlapping concepts and traditions in political theory . . . . [I]t has at its center an extremely simple conceptual model, . . . that the collectivity is an agreement between the individuals who make it up." Laslett, *supra* note 242, at 465.

246. The idea of "the state of nature," that is, what *we* are like, before the molding of our minds and personalities through socialization, culture, and language, beneath all of our indoctrination and education, is an idea that philosophers have considered since Protagoras, Plato, and Lucretius. Robert C. Solomon, *A Passion for Justice: Emotions and the Origins of the Social Contract* 57 (1990).

Although Thomas Hobbes characterized life in the state of nature to be "solitary, poor, nasty, brutish and short," a literal "war of all against all," Jean-Jacques Rousseau, 100 years later, viewed the state of nature as one where people were naturally happy and secure. *Id.* at 58; *see also* Sir Ernest Barker, *Introduction* to *Social Contract: Essays by Locke, Hume, and Rousseau*, *supra* note 244, at vii–xliv; *id.* at xix (contrasting Hobbsean state of nature as one in which each person does whatever he or she pleases without regard to interest of others with Locke's view that certain natural rights, such as to property, exist and restrain freedom of action even in *a priori* natural state).

247. Hobbes wrote:

> The Right of Nature, . . . [the] *jus naturale*, is the liberty each man has to use his own power, as he will himself, for the preservation of his own nature—that is to say, of his own life—and

Hobbes noted that societies exist in a warring state as each tries to survive, often at the expense of others.[248]

Later, Locke and then Rousseau argued that, even in the state of nature, individuals can reason and therefore will understand the advantage of coming together and agreeing on a mutually-protective social arrangement. Locke and Rousseau developed the core notion of the necessity of a rational consensus as the actualizing and legitimating mechanism for a just society.[249] In general, contractarians believe that if society's institutions are based on a consensus of its people, the society will be more principled and ordered than would be possible in either an *a priori* state of nature or under any other societal arrangement not predicated upon a social consensus.[250]

The notion of an initial consensus as being the predicate for and the means of deriving fundamental social principles reached its most refined version in the writings of the American philosopher John Rawls.[251] Although several prominent critics have not been persuaded by Rawls's

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consequently of doing anything which, in his own judgment and reason, he shall conceive to be the aptest means thereunto."

Hobbes, *Leviathan*, *supra* note 41, at 109.

248. *Id.* at 107. Hobbes described securing one's survival at any cost in the state of nature to be the *jus naturale*, or "right of nature," in contrast to the *lex naturalis*, the law of nature discoverable through reason which binds one to seek and follow peace. *Id.* at 109–10.

249. In discussing the "beginning of political societies," Locke commented that people by nature are free, equal, and independent, but that "by consenting with others to make one body politic under one government," they become obligated to everyone within that society to submit to the determination of the majority and to be bound by such determinations. John Locke, *An Essay Concerning the True Original, Extent and End of Civil Government*, in *The Second Treatise on Civil Government* (1690), reprinted in *Social Contract: Essays by Locke, Hume, and Rousseau*, *supra* note 244, at 3, 56–57.

250. Contractarian theories of social order are typically described in normative terms, due in part to the theological notions of the sanctity of covenants, in part to natural law concepts of universal obligations, in part to moral philosophy, particularly the categorical imperative of Immanuel Kant, and in part to the social significance of the institution of the promise in creating trust. David Hume, for example, wrote that "all contracts and promises ought carefully to be fulfilled, in order to secure mutual trust and confidence" among people in their common pursuits. David Hume, *An Enquiry Concerning the Principles of Morals* 28 (J.B. Schneewind ed., Hackett Pub. Co., 3d prtg. 1987) (1751). Trust as the result of any promise or consensus allows us to serve each other's purposes and to cooperate without fear of reprisal. *See* Charles Fried, *Contract as Promise: A Theory of Contractual Obligation* 8–12 (1981). Trust is an important social norm that in turn can contribute to efficient resolutions. *See infra* note 331 and accompanying text.

251. *See* Rawls, *supra* note 19; Rawls, *Political Liberalism*, *supra* note 27. For a partial bibliography of Rawls's works published between 1972 and 1989 relating to his theory of justice, see Pogge, *supra* note 27, at xi.

arguments,[252] and despite the confusion that has resulted from his continuing to develop aspects of his theory,[253] the consensual mechanism for achieving "fairness" that he has articulated remains relevant to any attempt to integrate fairness and utility theories.

D. The Rawlsean Model

Rawls's original version of *A Theory of Justice* begins with the proposition that a society is a cooperative venture of human beings structured for their mutual advantage.[254] He adds that a society is well-ordered not only when it advances the "good" of its members, but also when it is "effectively regulated by a public conception of justice."[255] A justly organized and run society is not a matter of fiat, a declaration by those at any moment in power, be they queens, kings, popes, presidents, or tyrants. Rather, Rawls states, justice requires a society in which "everyone accepts and knows that the others accept the same principles of justice."[256] Universal acceptance of preordinate principles presupposes an earlier consensus on those principles. This in turn presupposes that members of the society possess the capability of rational thought.

Rawls describes his aim as presenting a conception of justice that relied upon the social contract theory of Locke, Rousseau, and Kant, and advanced it to a higher level.[257] What this means is that Rawls's social contract is not just about prescribing forms of government; rather, it

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252. Rawls's critics have been numerous. *See, e.g.*, Robert Nozick, *Anarchy, State, and Utopia* ch. 7 (1974) (offering alternative theory of justice, "the entitlement theory"); *see also* J.W. Harris, *Legal Philosophies* 269–70 (1980). It has been said that, unlike Rawls, Nozick has a strong preference for liberty over equality. Heidi Li Feldman, *Libertarianism with a Twist*, 94 Mich. L. Rev. 1883, 1889 (1996) (citing Thomas Nagel, *Libertarianism Without Foundations*, 85 Yale L.J. 136, 136–38 (1975), *reprinted in* Thomas Nagel, *Other Minds: Critical Essays, 1969–1994*, at 137, 139 (1995)).

Another critic, Richard Posner, has attacked Rawls's theory of distributive justice. *See* Posner, *Economic Analysis of Law*, *supra* note 4, at 461–63. Posner claims that Rawls's theory is compatible with both socialism and laissez-faire capitalism. *Id.*

253. In *A Theory of Justice*, Rawls had asserted that his thesis was part of a rational decision theory, but in his later book, *Political Liberalism*, he modified his view and claimed that the principles of justice do not result primarily from rationality, but rather from intuition. Rawls, *Political Liberalism*, *supra* note 27, at 53 n.7; *see also* Lake, *supra* note 27.

254. Rawls, *supra* note 19, at 4.

255. *Id.* at 4–5.

256. *Id.* at 5.

257. *Id.* at 11.

focuses on deriving the *principles* that are used for establishing those forms.

Significantly, Rawls added that the principles of justice would also be necessary for regulating "*all further agreements*."[258] Although Rawls gave this phrase a narrow meaning, the language "all further agreements" can be read as including all agreements derived through the private autonomy of the people themselves, that is, all private contracts that the governmental arrangement acknowledges as being lawful and binding. This Article asserts that, even though Rawls did not intend to apply his theory to the derivation of contract rights, his agreed-upon principles of justice, in applying to all "kinds of social cooperation,"[259] should also govern private juristic relations, especially those deriving from contracts. Rawls chose to limit his discussion and application of his thesis to the level of abstract general principles applicable to ranking overall social arrangements for society. In this Article, however, we apply elements of his discourse into an *ex ante* model for determining private juristic relations. But before doing so, we need to consider relevant aspects of Rawls's theory.

1. Assumptions Regarding Rationality and Intuition

Rawls's thesis requires that members of society be capable of meeting and reaching a consensus on the basic tenets of justice. Why do people have the capacity to reach a consensus? Here Rawls, like Coase, must make epistemologic assumptions regarding human beings' capacity for rationality, as well as for intuition. Rawls's key assumption about rationality is the standard economic notion that adult members of society are capable of selecting and taking the most effective means to given ends.[260] A rational person, having a coherent set of preferences among available options, will rank those options as to how well they will further his or her purposes.[261] Rawls expands the means-ends reasoning in his hypothetical original position regarding taking effective means to ends, using unified expectations based on an objective interpretation of probability.[262] Rawls argues that by means of rational reflection,

258. *Id.* (emphasis added).

259. *Id.*

260. *Id.* at 142–43.

261. *Id.* at 143.

262. *Id.* at 146.

participants in the original position will come to understand the desirability of reaching a consensus on ranking principles, which would allow them to maximize their collective preferences.[263] Then, given their ability to rationally assess alternatives, their rational and intuitive nature will allow a ranking and consensus to be reached.[264] With these assumptions regarding human rationality and the role of intuition, Rawls next turns to setting out the conditions necessary for reaching consensus.

2. *Conditions for Reaching Consensu*

Arguably, Rawls's most innovative contribution to contractarian theory is not that a just society has to be built or that principles can be derived from a social consensus; rather, it relates to the set of conditions he posits as necessary for any normatively-based consensus. First, Rawls's theory requires that agreement on the principles must be made within what he labels "the original position," the hypothetical situation where participants (which Rawls acknowledges could be as few as one) capable of rational reflection come together to rank and agree upon the controlling principles.[265] The conditions underlying eligibility for entry into the hypothetical original position are critical in understanding how the Rawlsean methodology of consensus differs from the Coasean consensus model described in Part II above.[266] Foremost among the requirements Rawls sets out for eligibility is the requirement that participants "not be moved by envy."[267] Without envy, they would seek to maximize social goods uninfluenced by their destructive envious motives and feelings. This condition Rawls refers to as the "assumption of mutually disinterested rationality."[268] The method Rawls chose to

263. *Id.* at 11–12, 242–45.

264. *Id.* at 12.

265. *Id.* at 17–22.

266. *See supra* notes 70–87 and accompanying text.

267. Rawls, *supra* note 19, at 530–41; *see also* Jon Elster, *Envy in Social Life*, in *Strategy and Choice* 49, 75 (Richard J. Zeckhauser ed., 1991) (observing that "[t]he tendency to feel a pang of envy at another's fortune is universal"); Richard H. McAdams, *Relative Preferences*, 102 Yale L.J. 1, 14 (1992) (noting that "[e]nvy creates the conventional problem of an externality or third-party effect").

268. Rawls, *supra* note 19, at 144. In his later book, *Political Liberalism*, Rawls expands his discussion of rationality by noting that rational agents are not limited to means-ends reasoning, but that persons "may balance their final ends by their significance for their plan of life as a whole. . . . Nor are rational agents as such solely self-interested: that is, their interests are not always interests in benefits to themselves." Rawls, *Political Liberalism*, *supra* note 27, at 50–51. Rawls makes a distinction between what is reasonable and what is rational. To be reasonable is to

prevent envy from operating within the assembly was to limit each participant's knowledge about his or her own (and others') *specific* situation.[269] Here he sets out a critical condition, which avoids not only the influence of specialized envy, but also of greed and selfishness.

A credible criticism of the claim that people are capable of agreeing on basic principles of justice is that each person will be influenced by his or her own situation and, consequently, will be unwilling to agree with the others in the group. Because presumably each person seeks to gain and to protect those preferences that he or she most values, no collectivity will agree on generalized principles of justice, because each member will consider what is just situationally.

Consider this simple illustration. A rich person may rationally prefer to have zero taxes assessed on assets so as to preserve his or her maximum potential utility, while a poor person may rationally prefer the government to redistribute a portion of the rich person's assets (for example, through taxation and transfer payments) to alleviate the poor person's impoverished situation. Consequently, the rich person is more likely to perceive justice as a principle of *liberty*, which allows one to accumulate, preserve, and use the fruits of one's total utility with little or no governmental redistributive interferences. The poor person, however, is more likely to perceive justice as a principle of redistribution, requiring transfer of a portion of rich people's assets to poor people. The poor person would consider it unfair for conditions of extreme poverty to coexist with those of extreme wealth, a situation rectifiable through a principle requiring redistribution.

We contend that the avoidance of such emotive influences is necessary to overcome the bias of one's situation. More importantly, removal of a participant's particularized situational bias is necessary to overcome the collective pursuit of diverse self-interests, an impediment

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agree to abide by norms of cooperation applicable to all, where to be rational is an individual's use of one's powers of judgment and deliberation in seeking one's own ends and interests. *Id.* at 48–50. Rawls also indicated that his theory of justice was not, as he had earlier claimed, a theory of rational decision, but rather an intuitive one. *Id.* at 53 n.7.

Attacks on the assumption of rational self-maximizing choice have been numerous. One critic has suggested that the maximizing assumption can have serious effects: "[R]eal human beings are neither perfectly rational nor perfectly predictable.... In nonlinear systems—and the economy is most certainly nonlinear—chaos theory tells you that the slightest uncertainty in your knowledge of initial conditions will often grow inexorably. After a while, your predictions are nonsense." M. Mitchell Waldrop, *Complexity, The Emerging Science at the Edge of Order and Chaos* 142 (1992).

269. Rawls, *supra* note 19, at 136–42.

for reaching consensus. Therefore, assuming Rawls is right about the nature of envy, which we take as meaning that a person's situational bias results naturally from his or her circumstances, how can any ranking or consensus that combines both liberty and redistributive principles ever be reached? Rawls was keenly sensitive to this problem and understood that to reach a consensus, it would be necessary to nullify the effects of special contingencies, which place persons "at odds and allows them to be guided by their prejudices."[270] For Rawls, this meant finding an answer as to how each person's situational bias can be removed from the original position. His response was to establish, as a condition for entry into the hypothetical assembly, a limited state of knowledge, which would allow for rational consensus, but which would not permit the envy of the parties or their situational biases to exert any influence.

3. *The Veil of Ignorance*

Rawls's critical condition for removing the situational bias of each participant coming into the original position is to require that each enter under what he calls a "veil of ignorance."[271] It is assumed, Rawls states, that the parties do not know certain facts about themselves or about the society of which they are members. To quote Rawls:

> First of all, no one knows his place in society, his class position or social status; . . . his fortune in the distribution of natural assets and abilities, his intelligence and strength, and the like . . . his conception of the good, the particulars of his rational plan of life, or even the special features of his psychology such as his aversion to risk or liability to optimism or pessimism. . . . [T]he parties do not know the particular circumstances of their own society. That is, they do not know its economic or political situation, or the level of civilization and culture it has been able to achieve . . . [nor to] which generation they belong.[272]

In addition, the participants would not know any other group-identifying characteristics.[273]

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270. *Id.* at 19.

271. *Id.* at 136–42.

272. *Id.* at 137.

273. *Id.* at 12, 137.

On the other hand, each participant in the original position would know certain facts about human society generally. Rawls continues:

> They understand political affairs and the principles of economic theory; . . . the basis of social organization and the laws of human psychology . . . whatever general facts affect the choice of the principles of justice. There are no limitations on general information, that is, on general laws and theories . . . .[274]

The function of this limited veil of ignorance is that the rationality of each person is unaffected by his or her situational bias that otherwise would be present. Because "the differences" among the participants are unknown to the participants, and because everyone "is equally rational and similarly situated," each participant is convinced by "the same arguments."[275] In effect, there is no basis for the strategic bargaining that would induce each person's efforts to reach an agreement to his or her own advantage. No one will favor principles of justice designed to be more responsive to one situation than another. Therefore, the principles of justice that derive will result from a "fair agreement," untainted by situational bias. The results of the consensus then will incorporate both liberty and redistributive principles.

By using "fair" to describe the results of such a hypothetical consensus, Rawls, in effect, argues that justice as fairness results only when no party knowingly seeks an advantage at the expense of others. A consensus so reached, not having been influenced by situational bias or by opportunities for strategic bargaining, cannot be exploitative.

E. The Liebeler-Alchian ex ante *Model*

While Rawls chose not to apply his consensus model to the derivation of private rights and entitlements, Wesley Liebeler and Armen Alchian laudably have done so in an important but limited fashion.[276] Liebeler, a professor of law and economics, and Alchian, a professor of economics, have developed the parameters of a property rights system "that would emerge from *ex ante* contracts made by rational persons exercising equal liberty under zero transaction costs, knowing they would face

274. *Id.* at 137–38.

275. *Id.* at 139.

276. *See* Liebeler & Alchian, *supra* note 28 and accompanying text.

generalized ex post specialization caused by high transaction costs."[277] Relying in part on Hobbesean and Rawlsean notions,[278] and especially on the contractarian reasoning of David Gauthier,[279] Liebeler and Alchian developed an *ex ante* model to structure what they term "neutral baseline definitions."[280] These definitions will permit the common law that affects and defines private juristic relations to develop so as to maximize the preferences of every individual involved. How? First, the parties, before contracting *ex ante* their property rights (assuming no transaction costs), would need to disassociate their interests from any particular entitlements. For example, in a nuisance situation, the parties would not know what particular land parcels each owned. Thus, to use our earlier example, they would not know whether they were the owner of the land owned by the Polluter or by the Recipient.[281] As Liebeler and Alchian put it, "[W]e could ask what costs each owner would agree to accept from other nearby owners knowing ownership relations might be reversed."[282] Liebeler and Alchian's *ex ante* contracting model is based on the theory of specialized assets.[283] Their contract methodology uses a variation of the Rawlsean veil of ignorance to derive private law principles that maximize the value of individual preferences[284] in what is claimed to be a Pareto-superior manner.[285] We now will develop our own *ex ante* theory in which we incorporate into the Coase Theorem aspects of Rawls's hypothetical consensus model as modified by the influence of the social norms of risk aversion and fairness.

IV. A UNIFIED THEORY OF JUSTICE

The above discussions enable us to bring together various elements of Rawlsean insights on how to achieve distributive justice and the Coase Theorem for achieving efficiency to create a unified theory of justice that

277. *Id.* at 160.

278. *Id.* at 174–76.

279. *See* David Gauthier, *Moral Dealing: Contract Ethics, and Reason* 130–37 (1990); David Gauthier, *Morals by Agreement* 190–230 (1986).

280. Liebeler & Alchian, *supra* note 28, at 188.

281. *Id.* at 159.

282. *Id.* at 180. *See supra* text accompanying notes 81–85.

283. *Id.* at 157 ("Assets are specialized if their value is interdependent—if the value of each depends on what is done by or with the other . . . ."); *see id.* at 157–60.

284. *Id.* at 174–76.

285. *See supra* note 80 and accompanying text.

integrates a fairness standard into the efficiency construct. Ronald Coase and John Rawls, the former an economist and the latter a philosopher, not only have enriched their respective disciplines, but they also have made significant contributions to American law and jurisprudence. It may be difficult to imagine other scholars who have had as great an influence on jurisprudential discourse during the latter half of the twentieth century. Yet rarely has the synthesis of their respective insights been attempted. This Article represents such an effort. Our synthesis culminates in the development of a unified theory and a model for arriving at a hypothetical consensus that can be used to allocate private law entitlements and liabilities in various private law dispute situations.

A. Risk Aversion and "Constructive" Empathy

In discussing justice as efficiency in Part II, we implied that Coase's suggestion that any determination of the juristic relations among private parties or with the government can be based on a hypothetical model of consensus resulting from costless bargaining of those relations.[286] So, too, Rawls's model of consensus suggests that a society's constitutional framework and its recognition of human or fundamental rights, as well as its principles of encouraging liberty while responding to inequalities, results from a hypothetical model of consensus.

While the human capacity for rational empathy appears to be an irrelevant condition under the Coase Theorem, in Rawls's model it is a requirement. Under the veil of ignorance, the perceived necessity of making self-maximizing or norm-comfortable choices is what causes each participant to agree that a "security net" must be set up. As Richard Posner has described it, each person can foresee the possibility of needing the net.[287]

Posner has further pointed out that the Rawlsean notion that bargaining in the original position will result in "a set of arrangements that maximize[s] the position of the worst off" depends on the assumption that those in the original position are risk averse.[288] Before going further, we first discuss the social norm of risk aversion.

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286. *See supra* Part II.A.

287. Posner, *Economic Analysis of Law*, *supra* note 4, at 461.

288. *Id.*; *see also* Herbert Hovenkamp, *The Limits of Preference-Based Legal Policy*, 89 Nw. U. L. Rev. 4, 73 (1994).

Risk has been described as measurement of "the variation of actual outcomes from expected outcomes."[289] The expected outcome is the sum of each possible outcome multiplied by the probability of its occurrence.[290] For example, an investment might have a fifty percent chance of resulting in a $100,000 return and a fifty percent chance of yielding nothing. The investment's expected return is $50,000. Likewise, a different investment might have a certain result of yielding $50,000. The investment's expected return is also $50,000.[291] The difference between the two is that the first investment entails greater risk, because there is a wider range of possibilities with respect to possible outcomes.[292]

In theory, three responses to risk are possible. First, a person may be *risk neutral*, that is, indifferent as to the risk the investment presents.[293] Such a person will look only to the expected outcome of a decision. A risk neutral person, thus, would be indifferent as between the two investments described above. In fact, the risk neutral individual would prefer a third choice with an expected outcome of $51,000 regardless of whether that investment is more or less risky than the other two.

Second, a person may be *risk preferring*, or as some call it, *risk loving*.[294] A risk-preferring person is typified by an entrepreneur who prefers the possibility of a high actual return to the certainty of a lower actual return. Given the choice of the two investments with an expected return of $50,000, the risk preferrer would choose the first, riskier investment, preferring the possibility of an actual return of $100,000 rather than the certainty of an actual return of $50,000.

Finally, a person might be *risk averse*. All other things being equal, the risk averse person prefers to avoid risk.[295] A risk averse person, in choosing between the two investments with an expected outcome of $50,000, will choose the less risky, second choice, preferring the certainty of a lesser return over the possibility of a higher one. Depending on how risk averse the individual is, he or she might also

289. David N. Hyman, *Economics* 549 (2d ed. 1992).

290. Seidenfield, *supra* note 88, at 69–70.

291. *Id.* at 70.

292. *Id.*; Richard G. Lipsey et al., *Economics* 164 (9th ed. 1990).

293. Lipsey et al., *supra* note 292, at 164; *see also* Polinsky, *supra* note 4, at 51.

294. Lipsey et al., *supra* note 292, at 164; Seidenfield, *supra* note 88, at 71.

295. *See* Hyman, *supra* note 289, at 549; Lipsey et al., *supra* note 292, at 165; Polinsky, *supra* note 4, at 53; Seidenfield, *supra* note 88, at 71.

prefer the $50,000 certain return to the riskier investment with the higher $51,000 return.[296] Risk aversion, in other words, is a matter of degree.

There are several reasons to expect most people to be risk averse. First, as Richard Posner observes, "Risk aversion is a corollary of the principle of diminishing marginal utility of money."[297] Thus, Mark Seidenfield points out, "[F]or a poor person, another dollar may be the difference between going hungry and eating, while for a wealthy person, another dollar may make little real difference [in] her life."[298] Second, certainty as to expected outcome allows people to plan for the future.[299]

It is this risk aversion that leads those in Rawls's original position to act with "constructive" empathy. If those in the original position were risk neutral, they might create a social and economic structure that maximizes total social utility.[300] Such a system would maximize expected outcome. However, the maximum expected outcome might come from a system that resulted in a small percentage of the population having great wealth while the vast majority of those living in the society lived in abject poverty.

Because a rational person in the original position would see that he or she could be anyone, this would create two conflicting desires. First, the rational person would want social resources to be used in the most efficient way possible to create the highest expected outcome. At the same time, however, this desire would be balanced by risk aversion, creating an internal desire to narrow the range of possible outcomes. Such anticipated risk aversion would make those in the original position willing to settle for a *somewhat* lower expected possible outcome in order to ensure that the *actual* outcome, their position in society, did not

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296. The preferences of the risk averse can be more closely examined by looking at both positive and negative risks. Polinsky refers to positive risk as a "beneficial risk." Polinsky, *supra* note 4, at 55. For example, most people prefer the certainty of a regular salary from an employer to the possibility of making more money, but facing higher risk, working for themselves. With respect to a beneficial risk, a risk averse person might prefer the certainty of receiving $40,000 to a 50% chance of receiving $100,000 and a 50% chance of receiving nothing. The expected outcome of the first possibility is $40,000, and of the second possibility is $50,000, but the risk averse person (depending, of course, on the degree of risk averseness) will be willing to settle for less in order to avoid risk. This happens regularly in the settlement of lawsuits.

297. Posner, *Economic Analysis of Law*, *supra* note 4, at 12; *see also* Charles J. Goetz, *Cases and Materials on Law and Economics* 82–84 (1984); Seidenfield, *supra* note 88, at 72.

298. Seidenfield, *supra* note 88, at 72.

299. *Id.* at 73.

300. Posner, *Economic Analysis of Law*, *supra* note 4, at 462.

fall below a certain level. The resulting increase in expected welfare we call the equitable gain.

The choices those in the original position would make would depend on how risk averse they are.[301] Rawls suggests that this would result in a *maximin* principle, that is, the highest minimum actual outcome.[302] This assumes, as Posner observes, that people are "fantastically risk averse."[303] Although he does not accept the maximin result, Posner does state that "[s]ince risk aversion affects utility, utility-maximizing social policies will (depending on cost) include some redistributive provisions—some social insurance or 'safety net' for people who draw the short straws in life."[304] Although the degree to which risk aversion would affect the principles that result from the consensus may be controversial, that risk aversion would have some effect is not.

Thus, it should be apparent that the risk aversion of those within the veil of ignorance produces "constructive" empathy. As discussed above, empathy can be conceptualized not as an emotion, but as a rational mental capacity for understanding another person's situation.[305] The veil of ignorance produces constructive empathy because those in the original position do not know what positions they will occupy, so, given compliance with the social norm of risk aversion, they are forced to take into account the interests of everyone from the worst-off to the best-off. This response we call "constructive" empathy, because the concern is not rooted in emotions of pity, compassion, or sympathy, but results from a combination of rational self-maximizing and norm-satisfying accommodations. As Susan Moller Okin has observed, rational constructive empathy means that people in the original position care about others because they may be one of the "others."[306] They are willing to give up some level of potential well-being to ensure that their actual welfare does not fall below a certain level. In short, constructive empathy is a knowledgeable and rational self-interested response to perceived risk.

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301. *See* Posner, *Economic Analysis of Law*, *supra* note 4, at 462–63; Hovenkamp, *supra* note 288, at 73.

302. Posner, *Economic Analysis of Law*, *supra* note 4, at 461.

303. *Id.*

304. *Id.* at 462.

305. *See supra* notes 220, 225–26 and accompanying text.

306. Okin, *supra* note 19, at 246.

B. The "Fairness Effect"

The hypothetical Coasean world of no transaction costs can tell us what is theoretically efficient, but we do not live in that theoretically efficient world. The society created by those in the original position can tell us what is theoretically fair, but we do not live in that society either. Rather, we live in the "real" world, where achieving justice depends on crafting rules that are both fair *and* efficient.

That society should favor the efficiency of bargains is apparent to many, particularly those within the law and economics discipline. However, despite assorted normative arguments made by Fried, Kennedy, Tribe, Rawls, Henderson, and others, it is not clear to certain scholars that society should concern itself with the alleged fairness of contracts.[307] Nonetheless, given that law is instrumental[308] and that it ought to reflect the preferences of members of society, our legal rules *must* be concerned with fairness as well as efficiency. This is because the preferences of participants in real markets are simply not the same as those assumed by certain law and economics scholars. As we discuss below, members of our society, market participants, are concerned not only with the efficiency of their bargains but also with the bargains' perceived fairness.

We can observe this fairness concern in the response of bargainers to the division of the increase in perceived utility consequent to a bargain (its "surplus"). As predicted by standard economic theory, parties will not enter into a bargain unless they perceive that it will create a surplus. However, even if a bargain creates such added utility, parties may exhibit reluctance to enter into it if they perceive the division of the surplus to be unfair.[309] Consider the following hypothetical example:

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307. *See, e.g.*, Richard Epstein, *Unconscionability: A Critical Reappraisal*, 18 J.L. & Econ. 293 (1975).

308. *See supra* note 2.

309. *See* Sunstein, *Social Norms*, *supra* note 9, at 944. Sunstein explains this phenomenon:

> When two people are to divide an amount given them . . . the offeror . . . feels shame given prevailing norms—that he is demonstrating that he is a greedy and even horrible person—if he offers a penny or a dollar from a sum of (say) $200. . . . For his part, the offeree feels mistreated—treated in a contemptuous way—if a small or token amount is suggested. The social meaning of the statement, "How about five cents for you?" is contempt; the social meaning of responding, "Great!" is a willingness to be dishonored.

Id. (citations omitted).

Harry owns a piece of vacant land on which he has thoughts of building a house in the future. Because of this planned use, the land is worth $10,000 to him. He is approached by Leah, who offers to buy the land for $12,000. Harry finds out that Leah is planning to build a factory on the land, and that because the land is particularly suited for the type of factory she wishes to build, the land is worth $140,000 to her. Only Leah has the knowledge and resources to build this type of factory. Harry turns down Leah's offer; he would rather hold on to the land than get "ripped off," he tells her.

Harry's response may not be "rational." If the land is worth $10,000 to him, then he is better off if he accepts an offer to buy it for $12,000, regardless of whether it is worth $14,000 or $140,000 to Leah. Nonetheless, the "fairness effect" accords with the way participants in real markets often make decisions.[310]

Although the existence of the fairness effect may seem intuitively obvious to non-economists, it has also been empirically demonstrated. Elizabeth Hoffman and Matthew Spitzer conducted a series of laboratory experiments designed to test the validity of assumptions underlying the Coase Theorem. In the first of these experiments, one or two parties out of two-person and three-person groups had to choose from a selection of numbers.[311] Each of the numbers represented different payoffs to each person; the number that represented the highest total payoff to both parties was not the same as the one that represented the highest payoff to one party if there was no exchange.[312] In all of the situations, one party made the decisions, side payments were allowed, and the contracts were

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310. *See* Buckley, *supra* note 9, at 54. Buckley states:

> Fairness norms may be strongly felt, with bargainers willing to bear a personal loss to punish another party for unfairness. In ultimatum games, for example, one party (the "controller") divides up a fixed amount of money and the other must accept or reject his share. If he rejects it, neither party receives anything. Although it might seem rational for the second player to accept any offer, a substantial portion of such parties are willing to reject unequal, positive offers.

Id. (citing Selten, *The Equity Principle in Economic Behavior*, in *Decision Theory and Social Ethics, Issues in Social Choice* 289 (H. Gottinger & W. Leinfeller eds., 1978), and Kahneman et al., *Fairness and the Assumptions of Economics*, 59 J. Bus. S285 (1986)).

Psychologist Robert Frank makes an interesting point regarding a person who is perceived by others as disliking unfair bargains: "[A] person who is known to 'dislike' an unfair bargain can credibly threaten to walk away from one, even when it is in her narrow interest to accept it. By virtue of being known to have this preference she becomes a more effective negotiator." Robert H. Frank, *Passions Within Reasons: The Strategic Role of the Emotions* 5 (1988).

311. Hoffman & Spitzer, *The Coase Theorem*, *supra* note 9, at 84.

312. *Id.*

written and strictly enforced.[313] In certain situations, the parties knew what the payoffs were to be to the other party from each decision, while in others the parties were not given that information but were allowed to share it if they chose.[314] In addition, certain parties had to reach two sets of agreements, but did not know while reaching the first who would be the decisionmaker in the second.[315]

As Hoffman and Spitzer expected, in approximately ninety percent of the 114 decisions, the parties chose the number that maximized total payoffs, that is, the "efficient" number.[316] More surprising to them, however, was that sixty-seven of the 114 groups then divided the total payoff evenly or close to evenly.[317] This meant that, in many cases, parties knowingly chose an allocation of the payout that left them with a lower marginal return than they would have received had they chosen the result that maximized their individual payouts. Hoffman and Spitzer explained that if the decisionmaker can choose between an outcome that gives the decisionmaker twelve dollars and the other party zero dollars, or another outcome that produces a total payout of fourteen dollars for the two parties, "[u]nder no circumstances should the [decisionmaker] settle for less than $12."[318] In contrast to this prediction, however, many of the parties divided such a payout with seven dollars to each party.[319]

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313. *Id.* at 82–91.

314. *Id.*

315. *Id.* at 86.

316. *Id.* at 91. Almost all of the groups that did not reach the efficient decision were three-person groups in which there were two decisionmakers and in which the parties were not given information about the payoffs to the other parties. *Id.*

317. *Id.* at 93.

318. Hoffman & Spitzer, *An Experimental Examination*, *supra* note 9, at 259.

319. *Id.* at 260. In an experiment that followed their original article, Hoffman and Spitzer tried to determine what caused this unexpected result. *Id.* at 260–61. They used essentially the same set-up as in their first experiment, except that they used only two-person groups, and they determined which party would be the decisionmaker in some cases with a coin flip and in other cases by picking the party who won a simple skill game. *Id.* In half of each of these cases, the groups were told that the decisionmaker had "earned" the position, and the others were told that the decisionmaker was "designated." *Id.* at 267–72.

Again, about 90% of the groups chose the number that maximized the group's total payout. *Id.* at 275. Hoffman and Spitzer found that both the way in which the controlling party is picked and what label is put on that decision made a significant difference in the outcome. *Id.* at 280. In the groups that picked a decisionmaker by a game and were told that the position was earned, 68% of the time the decisionmaker received "at least his individual maximum." *Id.* at 275. Of the groups told instead that the position of decisionmaker was designated, 61% divided the payout evenly between the parties, leaving the decisionmaker with a less-than-optimal total payout. *Id.*

Other scholars have conducted experiments with what economists call the "ultimatum game."[320] The rules of this game are as follows:

> The people who run the game give some money, on a provisional basis, to the first of two players. The first player is told to offer some part of the money to the second player. If the second player accepts that amount, he can keep what is offered, and the first player gets to keep the rest. But if the second player rejects the offer, neither party gets anything. Both [parties] are informed that these are the rules. No bargaining is allowed.[321]

If economists' assumptions of rationality were correct, "the first player should offer a penny and the second player should accept."[322] In actuality, however, offers are normally between thirty and forty percent of the total and are sometimes fifty percent, while offers of less than twenty percent are often rejected.[323]

F.H. Buckley identifies several factors that help explain the reluctance of participants in real—as opposed to theoretical—markets to enter into contracts that are perceived to be substantively unfair.[324] First, unlike theoretical negotiations in the neoclassical economic model, transactions in actual marketplaces are costly in time and resources, especially in gaining relevant information. Bargains that would make both parties better off will not be reached if the transaction costs of reaching those bargains are too high. The norm of fairness in bargaining "reduce[s] the probability of a bargaining breakdown by providing a *focal point* for agreement."[325] Not having this focal point, a breakdown in bargaining may occur because of a problem referred to as "the Negotiator's Dilemma."[326] Bargainers wish to acquire as much of the surplus as possible, but "a claim for disproportionate individual gains may result in a breakdown of negotiations and a loss of joint gains."[327] Cooperation in bargaining may prevent this problem:

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320. Sunstein, *Social Norms*, *supra* note 9, at 904.

321. *Id.*

322. *Id.*

323. *Id.* at 904–05.

324. *See* Buckley, *supra* note 9, at 48–59.

325. *Id.* at 48.

326. *Id.* at 49 n.63 (quoting D. Lax & J. Sebenius, *The Manager as Negotiator: Bargaining for Cooperation and Competitive Gain* 38 (1986)).

327. *Id.* at 48–49.

> In any society, the level of bargaining will depend on the prevalence of norms of cooperation. Amongst a group of unconstrained maximizers, the pursuit of individual gains will reduce the number of agreements which are concluded. In a less grasping society, by contrast, habits of compromise will encourage the formation of contracts. The first society will then be poorer than the second.[328]

Thus, by providing a starting or focal point for bargaining, the normative expectation that the surplus from a bargain will be divided fairly can reduce bargaining costs, thereby leading to greater efficiency.

Second, there are costs to consumers in reading and understanding the terms of standard form contracts.[329] If these costs are sufficiently high, consumers are presented with a choice between either not entering into agreements or entering into agreements they do not fully understand. If consumers enter into bargains without full information, "[t]erms which would be efficiently specified if all consumers were to screen [the agreements] might . . . be abandoned for terms which inefficiently favor the merchant."[330] Rather than take this risk, consumers might choose not to enter into the agreement at all. Consequently, when the participants in a market trust that they will be dealt with fairly, they will more likely enter into agreements; when market participants fear that they will be treated unfairly, they will be reluctant to enter into agreements—including those that might otherwise be rational and efficient from an economic perspective. A norm of substantive fairness in contracting thus encourages a greater level of contracting by reducing the risk that an unread standard form contract will be one-sided.

Other economists have demonstrated that a social norm of trust increases the level of bargaining and thereby improves efficiency.[331] Likewise, a social norm of fairness in the distribution of the surplus created by a bargain will encourage parties to enter into bargains that are efficient, but which they might be reluctant to enter into if they fear being treated unfairly.

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328. *Id.* at 49.

329. *Id.* at 59–60.

330. *Id.* at 62.

331. *See* Francis Fukuyama, *Trust: The Social Virtues and the Creation of Prosperity* (1995); Russell Hardin, *Trusting Persons, Trusting Institutions*, in *Strategy and Choice* 185–209 (Richard J. Zeckhauser ed., 1991).

Whether the reasons set forth by Buckley and others are the best explanation for the fairness effect or not, that effect does exist. Consequently, a realistic model for justice must be concerned about both the efficiency and distributive fairness of agreements. Not only are fairness and efficiency important goals in and of themselves, but, in the real world, they are interdependent. This leaves us with the question of how, without sacrificing the efficiency goal, we can assure that the terms of contracts are substantively fair.

C. Integrating the Condition of Hidden Identity into the Coase Theorem

We can integrate fairness into efficiency by introducing one of Rawls's tools into the Coase Theorem. By modifying Rawls's veil of ignorance and introducing it into Coase's model, we can create a theoretical consensus construct that allows us to ensure that a particular bargain is both fair and efficient. To put it simply, assume that Rawls and Coase have separately developed games for reaching consensus. For both games, the game-master has developed rules or conditions for entry. Rawls's version of the game demands that the players know nothing about themselves, that the veil of ignorance as to their own situation be complete so as to prevent any possibility of bargaining for their own advantage at the expense of the group. The object of the game is to reach a consensus that will maximize the well-being of each of the parties while minimizing the risk to each.

Coase, on the other hand, demands that players come to his bargaining game with full knowledge of who they are and what they want, besides knowing all relevant facts about each and every one of the other players. The object of this game is to reach a final consensus on a set of trade-offs by which each party attains a net increase in value.

In Coase's game, each party's situational bias and observance of perceived norms drive the game. Thus, the parties are free to pursue their particularized self-interests, using their situations and social knowledge to their advantage. This allows a strong party at the table to bargain or to draft to the max,[332] including inserting into a form "agreement" remedial provisions that, for example, would give that party every possible right

332. Drafting to the max occurs when a party having grossly superior bargaining power uses that power to exact an agreement that limits, to the extent the law permits, the stronger party's own liabilities under the "agreement" while maximizing its legal rights should the weaker party default, and where, in addition, the events of default are defined unilaterally by the stronger party.

to preserve and protect its initially gained increase in utility in the event of the other party's default, while limiting its own liability in the event of its own default.[333]

In contrast, in Rawls's original position, the game is driven in part by uncertainty as to the implications of any consensus reached among the parties. Rawls avoids the problem of situational bias by preventing the parties from knowing which terms of the consensus would situationally benefit them. The risk aversion of the parties under Rawls's veil of ignorance produces a more even distribution of the surplus utility that will be generated.

Recall that Rawls's moral philosophy focuses his consensus model on deriving "just" principles for organizing and administering a "well-ordered" society, while the Coasean consensus model focuses more on the resolution of issues of legal entitlements, especially in areas of private law—torts, property, and contracts. Despite the dissimilarity of focus, we propose to use a Rawlsean tool to modify the Coase Theorem, thereby creating a method for the analysis of private law issues that tempers efficiency with fairness and acknowledges social norms producing a "fairness effect," which in turn weakens the assumption of pervasive self-maximizing behavior. A Rawlsean tool for achieving fairness can be integrated into the Coasean model for two reasons. First, each model depends upon a similar methodological concept to reach its goals: a hypothetical consensus. Second, both Coase and Rawls (Rawls to a lesser degree) assume the participants will be rationally self-seeking in reaching consensus.[334]

The solution we propose is to modify Rawls's "veil of ignorance" into what we term the "condition of hidden identity," and then insert that condition into the Coase Theorem. The condition of hidden identity assumes that each affected person has full knowledge of each party's age, race, sex, status, and social and economic condition, in contrast to

333. Consider, for example, a contract for the sale of goods, in which the seller uses a dragnet, cross-collateral clause along with a disclaimer of all warranties provision.

334. This is an assumption somewhat at odds with modern construction theory concerning social norms and meanings. *See supra* notes 170–75 and accompanying text. An awareness of social norms that impede efficient bargains is important, particularly to highlight classes of bargaining that might be made more efficient and/or more fair by emulation of the bargain that would be reached under the unified model. However, the assumption is crucial to ensuring that the hypothetical bargain the parties reach will be efficient. To modify this assumption to reflect the social norms that affect people's willingness to enter into bargains would both complicate the model enormously and prevent it from resulting in all efficient bargains being reached.

the more limited knowledge assumptions under the veil of ignorance. But unlike Rawls's more comprehensive veil of ignorance, the condition of hidden identity assumes only that any party operating under it does not know which party to the bargain he or she will be.

In short, our "hybrid" model retains all of the assumptions of the Coase model, save one: the assumption that the players have perfect knowledge. Rather, the parties seeking consensus will have the complete knowledge Coase assumes, except that they will operate under the condition of hidden identity. For example, in a pollution controversy, the parties would not know if they were the Polluter or the Recipient, but they would know all of the costs and benefits to each party for each possible alternative resolution of the dispute. Under our proposed unified theory of justice, the rules of Coase's game would thus change so that each player would come to the table knowing not only everything relevant about each other player, but also knowing the social norms and meanings that will influence each player, including norms of risk aversion and perceived fairness; but no player would know which party he or she would be.

Will the results of this new game be efficient? If the parties could reach an agreement under the traditional rules of the Coasean game, they could reach one under the rules of the hybrid one. In either case, the parties would enter into an agreement only if they perceive it to increase the welfare of each of the parties at least marginally.

Although the insertion of the condition of hidden identity would in most instances not affect whether players in the hybrid model would reach a consensus, it would in certain situations affect the terms of that consensus. Just as the veil of ignorance negates the effect of situational bias in the original position, the condition of hidden identity negates the effect of gross disparities in bargaining power existing in imperfectly competitive markets. When great disparities in bargaining power do not exist, the consensus reached would likely be the same or similar as if the parties had known their identities. In other cases, however, the pursuit of self-interest will be tempered by the risk-aversion norms of the parties. Being influenced by the norm of risk aversion, the players will not want to insert terms into the agreement that are not essential for reaching consensus but that are one-sided or exploitative, since they will not know on which side of the agreement they will be. With this precautionary mind-set, they will agree to allocate the expected surplus in a manner considered "fair" for both parties.

D. Applications: Examples

The Coasean-Rawlsean model described above can be applied to a wide range of situations that have presented problems for the law. These include doctrinally troublesome areas such as: how to establish fairness in contracts alleged to be adhesive or unconscionable; under what circumstances gratuitous promises made in response to benefits the promisor previously received from the promisee should be enforced; under what circumstances should courts construct implied-in-law contracts, also called quasi-contracts, to remedy problems of unjust enrichment; under what circumstances should gratuitous promises that induce injurious reliance by promisees be enforced; when is it appropriate for courts to consider non-economic values, such as esthetics, in contract disputes; and how courts should resolve legal liabilities and entitlements in traditional nuisance situations.

The authors are concurrently exploring these and other topics for a forthcoming article; for now, we offer a few situations where our hypothetical model would be of practical assistance to courts in resolving a wide range of disputes. We leave a more detailed analysis for later publication.

1. Fairness of the Exchange: Unconscionability

Recall the case of *Williams v. Walker-Thomas Furniture Co.*,[335] involving a retailer's use of a cross-collateral, pro-rata payment clause in a consumer credit transaction. Following the consumer's default, the retailer asserted a right to repossess items sold to the consumer years earlier, items she thought she had paid for.[336] On the one hand, the intuitive "justice-as-fairness" response to the facts of this case is typified by the comments of Arthur Leff, who stated, "For those of us who have an instinctive and infallible sense of justice (and which of us does not), any other result [than the presumption of unconscionability] in this case is unimaginable."[337] Under a pure fairness approach, the cross-collateral clause would not be enforced at all; Walker-Thomas would have no security-interest recourse against Williams.

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335. 350 F.2d 445 (D.C. Cir. 1965).

336. *Id.* at 447.

337. Arthur Allen Leff, *Unconscionability and the Emperor's New Clause*, 115 U. Pa. L. Rev. 485, 552 (1967).

There are several problems with this approach. First, on what criteria is a judge to determine which contract provisions are unconscionable? Even Leff had difficulty in identifying exactly what it was that made the transaction seem instinctively unjust. Was it that the consumer was unaware of the clause or, even had it been pointed out to her, how it operated? Was it the combination of cross-collateral and pro-rata payment clauses? Was it that the consumer did not need, in the eyes of some perhaps, the stereo: that is, was it because the seller had knowingly sold her a frill (as the lower court paternalistically suggested)?[338] Or was it because she was unaware of the clause's potential effect when signing the agreement and was subsequently "surprised" when told that the retailer could repossess all the items he had previously sold to her? Intuition alone does not isolate the factors.

On the other hand, there may be good reasons for enforcing cross-collateral clauses in consumer contracts. A retailer may perceive the need for collateral as a condition for extending credit in selling goods to protect an expected utility gain. Thus, a legitimate commercial purpose exists for allowing cross-collateral clauses. Richard Epstein has argued that these clauses aid buyers as much as sellers, because their use allows buyers in many instances to acquire goods or services that, but for the seller's security interest in the buyer's property, the buyers would not have been able to purchase.[339] Thus, any reaction to *Walker-Thomas* that would outright ban the use of such clauses in consumer credit sales would likely produce a net loss in welfare. Nonetheless, the Federal Trade Commission has imposed such a ban.[340]

Consequently, a pure "justice-as-fairness" response of banning cross-collateral clauses in consumer credit contracts arguably hurts those it is intended to protect—consumers in need of credit. It may be that for every person in Williams's situation who is prevented from becoming overextended, defaulting, and losing everything, many other consumers are being prevented from obtaining net increases in utility that they otherwise could have obtained.

But on the other hand, the argument made by Epstein, that add-on or cross-collateral clauses ought to be enforced because they are efficient,

338. Williams v. Walker-Thomas Furniture, 198 A.2d 914, 916 (D.C. 1964).

339. *See* Epstein, *supra* note 307, at 307 (observing that "[t]he 'add-on' [cross collateral] clause allows both parties to benefit from the reduction in costs in the setting up of a security arrangement"); *see id.* at 306–08.

340. *See* 16 C.F.R. § 444.2(a)(3) (1997).

does not respond to the intuitive sense of injustice Leff and so many others have felt in reacting to the particular facts of the *Walker-Thomas* case. A better explanation of this sense of injustice may be the social perception that the "surplus" is too one-sided, considering that Williams was never allowed to pay off completely any of her prior purchases due to the pro-rata payment allocation provision included in the cross-collateral clause.

Our unified model, in contrast, allows for the consideration of both the fairness and the efficiency aspects of such an agreement. Our model asks, is this agreement in the form that the parties would both be willing to enter into assuming a costless bargaining setting where they understood all trade-offs, but where neither knew which party he or she would be (the condition of hidden identity)? That is, how would constructive empathy change the shape of the bargain that the parties would reach? We tentatively suggest that the retail installment sales contract would still include a cross-collateral clause, but with no pro-rata payment allocation characteristic. It would be understood that when the purchase price of any item previously purchased had been paid as well as the outstanding interest on that amount, the seller's security interest in that item would cease and the purchaser would own the item free and clear.

2. *Gratuitous Promises for Benefits Previously Received*

In the case of *Mills v. Wyman*,[341] the Massachusetts Supreme Court held that the promise of a father to pay the final expenses of care to his deceased son's caretaker was not enforceable because the promise lacked consideration.[342] The facts of *Mills* fall within that group of cases in which a promisor makes a gratuitous promise, often in gratitude or appreciation for benefits previously received from the promisee, benefits that themselves were given gratuitously.[343] The *Mills* court commented that the father who made the promise was morally, but not legally, obligated to perform, holding that there was no actual bargained-for consideration for the promise.[344]

If the Coase theorem were applied to *Mills*, the result would be the same. Why? Because the promisor would not have agreed to be obligated

341. 20 Mass. (3 Pick.) 207 (1825).

342. *Id.* at 208–09.

343. *Id.* at 209.

344. *Id.*

to give anything in exchange for a service that, when given by the promisee, the promisor knew would be offered gratuitously. In other words, the most efficient allocation of the parties' rights would not make the promisor, the father, liable for breaching his promise, since he would not have agreed *ex ante* to be liable knowing the promisee would demand nothing in exchange. Although efficient, the result was nonetheless felt by the *Mills* court to be unfair.

In contrast, under our model, a court would hold that the father's promise was enforceable. Since the promisor and the promisee would know everything that would transpire in the situation except their respective identities, each party *ex ante* would agree that the promise be enforceable, since either could end up being the promisee (who would benefit from enforcement of the promise) and since the promisor (again potentially either party) would still receive the benefit of knowing his dying son was cared for in his last illness. Enforcement of the promise to pay for the caretaking services would still be an efficient transaction, both parties voluntarily choosing to enter into it, but now it would also represent a fair division of the benefits created—the caretaking of the dying son, the gratitude for that care by the father, and the enforcement of the promise to pay money in recognition of those benefits. In other words, to enforce the promise produces an equitable gain in net benefits, and thus the solution would be both efficient and fair.

Another example of a promise to pay for benefits previously received that would be enforceable under our Coasean-Rawlsean model is the 1935 case of *Webb v. McGowin*.[345] There, a worker in a lumber yard was cleaning an upper floor in a millhouse and was starting to drop a large block of wood to the ground when he saw that his employer was directly beneath him. The employee held on to the block to divert its direction, and, in doing so, fell to the ground below, preventing death or serious injury to his employer, but at the cost of sustaining serious bodily injuries himself that crippled him for life.[346] Later, the employer, in genuine gratitude, promised to pay his injured employee fifteen dollars every two weeks for the rest of the employee's life. After the employer died, his estate refused to make subsequent payments.[347]

The court held that the promise to pay was one for consideration, given the materiality of the benefit the promisor had received from the

345. 168 So. 196 (Ala. Ct. App. 1935).

346. *Id.* at 196–97.

347. *Id.*

previous action of the promisee.[348] The court's decision to enforce the promise may have been admirable, but its rationale was a distortion of the bargain-for-exchange concept underlying the doctrine of consideration. There was no bargain, as the employer's promise was gratuitous, having been based on the employee's previously-rendered gratuitous (albeit potentially life-saving) act.

If the Coase theorem were applied, and we were to ask what the promisor would have agreed to if, *ex ante*, he knew what might result, the promise still would not be enforceable. The promisor, with perfect knowledge of what actions the promisee would take, would know that the promisee would demand nothing in exchange for his gratuitous action. Therefore, no bargain would be necessary to attain the desired result, and there would be no right on the part of this injured employee to any later-promised compensation from his employer, this being the efficient resolution.

If a court were to apply our model, however, meaning that neither party would know if he or she were the promisor or the promisee, a different rationale of fairness for enforcing the promise would result. Since each party could foresee being the injured-for-life promisee, each would want the promisor to be legally obligated to keep his promise and would so agree in a hypothetical contract.

Today, the *Mills* and *Webb* cases would come under the amorphous principle of section 86 of the Restatement (Second) of Contracts, which states that promises based on benefits previously received by the promisor from the promisee should be enforceable to the extent necessary to prevent injustice.[349] How is a court to decide if such a promise ought to be enforced? What does the prevention of injustice involve? Application of our model provides the answer.

3. *Quasi-Contracts*

Similar to situations involving promises for benefits previously received are instances in which someone receives a benefit and later a court creates or constructs a fictitious contract between the benefit-giver and the benefit-recipient, although no actual contract existed nor were promises made—a sub-area known as "quasi-contracts," which comes

348. *Id.* at 198.

349. *See* Restatement (Second) of Contracts § 86 (1979).

within the legal category referred to as restitution.[350] An example of a case of this type is *Cotnam v. Wisdom*,[351] where the court constructed a quasi-contract (sometimes called either a constructive or an implied-in-law contract) between a person left unconscious by a street car accident and the physicians who furnished emergency medical services. The physicians were unsuccessful in saving the victim's life and later sued the victim's estate for the value of the services rendered.[352] The court recognized that a fictitious contract was necessary to "afford a remedy,"[353] although doing so was admittedly "not good logic."[354]

Under our model, the parties *ex ante* would have agreed, under a hypothetical contract, to create a duty to pay for the services, the duty being allocated to the one who received help. Either party could be the one in need of emergency medical services and, therefore, would want to encourage their rendition.

4. *Gratuitous Promises Inducing Reliance*

Gratuitous promises that induce foreseeable injurious reliance on the part of promisees would also be enforceable under our thesis.[355] So-called promissory estoppel, where courts enforce gratuitous promises to the extent that "injustice can be avoided,"[356] can be explained as an attempt by courts to allocate private rights and liabilities fairly in non-bargained-for promissory situations where one party has relied to his or her detriment on a promise. Again, if the parties did not know which party they would be—the promisor whose promise foreseeably would induce the detrimental reliance, or the promisee who would so rely—then a hypothetical Coasean-Rawlsean contract would answer the

350. "'Quasi contract' is a useful term for describing a ground for recovering money in an action at common law, when the claim is not based either on principles of tort law or on a true contract but instead seeks redress for unjust enrichment." E. Allan Farnsworth & William F. Young, *Cases and Materials on Contracts* 77 n.c (5th ed. 1995).

351. 104 S.W. 164 (Ark. 1907).

352. *Id.* at 165.

353. *Id.* at 166.

354. *Id.*

355. This scenario will be analyzed more fully in a subsequent article.

356. "A promise which the promisor should reasonably expect to induce action or forbearance on the part of the promisee or a third person and which does induce such action or forbearance is binding *if injustice can be avoided only by enforcement of the promise.*" Restatement (Second) of Contracts § 90 (1979) (emphasis added).

questions of whether the promisor should be liable, and, if so, to what extent.

5. *Judicial Consideration of Non-Economic Values*

In *Peevyhouse v. Garland Coal & Mining Co.*,[357] the Oklahoma Supreme Court described a contract between a strip mining firm (Garland) and landowners (the Peevyhouses), which allowed Garland to strip mine the Peevyhouse farm for five years and then to perform restorative and remedial work, as a contract "merely to accomplish the economical recovery and marketing of coal from the premises, to the profit of all parties."[358] Consequently, even though the mining company had intentionally breached its contract by not restoring the land as promised, the court, by a five-to-four margin, allowed the farm owners to recover only $300 in damages, the so-called diminution-in-value measure,[359] rather than the $25,000 asked for by the Peevyhouses, an amount that would have approximated the cost of completion of the restoration. Why? Because, the court reasoned, the resale value of the Peevyhouse farmland had only been reduced by $300; thus, it would be economic waste to require the strip miner to restore the land as promised.[360]

The majority opinion of the court evidenced no empathy with the landowners' situation, although the Peevyhouses valued the restored appearance of their land as much as Garland valued the right to strip the coal from it. How do we know? Because this was the actual contract agreed to; the restorative obligations were part of the bargain. Had the court considered the contract not only as one for economically retrieving coal, but also as one requiring the restoration of the esthetics of the landowners' property—had it been able to stand in the shoes of both parties—it would have seen that a fair division of the net increase in equity produced by the contract required that it be enforced so as to demand cost of completion damages under these circumstances.

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357. 382 P.2d 109 (Okla. 1962).

358. *Id.* at 112.

359. The diminution in value in this case was calculated as the difference in value between the property before the mining had taken place and the value of the land after the mining had been completed. *Id.* at 114.

360. *Id.* at 112–14.

6. Nuisance Law

Finally, the circumstances of *Boomer v. Atlantic Cement Co.*[361] provide an example of a dispute in which the result using the Coasean model or applying the unified theory model would be the same, but would differ from the older, traditional resolution under nuisance law principles. *Boomer* involved a cement plant near Albany, New York, whose operation involved the discharge of large quantities of dust and excessive vibration from blasting.[362] The cement factory had cost more than $45 million to build and employed more than 300 people.[363] The effects of the pollution diminished the value of the neighbors' property by approximately $185,000.[364]

The traditional resolution of such nuisance suits in New York was a property rule, an entitlement protecting landowners' rights to quiet use and enjoyment of their property. Under this traditional analysis, the "cause" of the landowners' harm in the *Boomer* case was the factory; the court focused on the fact that the harm "caused" by the factory interfered with the property owners' quiet use and enjoyment. Since the factory's operation was found to be a nuisance interfering with these property rights, it would have to be shut down, and an injunction would be issued.[365] Under the traditional analysis, this would be the result even if the harm (disutility) caused by the nuisance was much less than the net social utility created by the factory.

While it may appeal to a particular sense of fairness to say that if a factory is causing its neighbors harm, it ought to be shut down, this "resolution" has two problems. First, as Coase pointed out in *The Problem of Social Cost*, it oversimplifies the problem to state that an externality cost is "caused" by one party or another.[366] One could just as easily say that the landowners "caused" the problem by living close to the factory. Second, and more importantly, the property owners' entitlement rule ignores the loss of the social utility that results from

361. 257 N.E.2d 870 (N.Y. 1970).

362. *Id.* at 871.

363. *Id.* at 873 n.*.

364. *Id.* at 873.

365. See, for example, *Whalen v. Union Bag & Paper Co.*, 101 N.E. 805 (N.Y. 1913), where the court reinstated an injunction against a pulp mill's operation in favor of a downstream riparian owner when the mill cost in excess of one million dollars and the riparian owner's economic loss was "small." *Id.* at 805.

366. Coase, *Social Cost*, *supra* note 4.

shutting down the factory. In the *Boomer* situation, the transaction costs for the parties themselves to reach a private resolution of this dispute would likely be so high as to negate any private consensus. If the landowners were unable to come to an agreement with the factory because of prohibitively high transaction costs, under the traditional approach the factory would have been shut down. Doing so would mean losing a factory that increased social welfare by $45 million while preventing a harm to landowners that the court found to be about $185,000.[367]

Rather than permit this outcome, the court in effect used a justice-as-efficiency approach, arguably imposing on the parties the agreement that would have resulted had the parties been able to bargain costlessly.[368] The court imposed a liability rather than an entitlement rule, allowing the factory to continue its operations, but requiring it to pay provable damages to the landowners. This result compensated the landowners for their losses, but allowed the factory to remain open, a resolution that clearly promoted efficiency and wealth maximization.

In this instance, applying our Coasean-Rawlsean model would produce the same result as the court reached, consistent with the Coase Theorem. The parties would know that reaching an agreement would increase their net welfare; and while the landowners would have no alternative but to deal with the factory to resolve the pollution problem, likewise the factory would have no other alternative than dealing with the homeowners. Thus, it would be important to both parties to reach a consensus. Operating under the condition of hidden identity, the parties would realize that they could be the factory owners, and therefore they would want to ensure that the factory could continue to operate profitably. The parties would also realize that they could be the property owners, and they thus would want to ensure that they would receive adequate compensation for the injuries they suffered from the factory's pollution.

The above examples illustrate a few areas where a combined Coasean-Rawlsean *ex ante* hypothetical consensus model can be used, not only to explain the soundness of many decisions, but also to assist courts in deciding those issues where "justice" and "fairness" are included within the decisional criteria. Ongoing research and analysis will, we believe,

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367. *Boomer*, 257 N.E.2d at 873 n.*.

368. *Id.* at 874–75 (awarding what court called "permanent damages" to landowners).

reveal other areas where the model is workable and will provide further assurance that dispute settlement can be both efficient and fair.

V. CONCLUSION

Where perfect competition exists, the terms of any allocation of entitlements and liabilities will be set solely by the marketplace,[369] and the relative bargaining power of individual parties will have no discernible effect. Consequently, our model need not be applied in every circumstance. Unlike the Coase Theorem, our model relies on a weak version of the assumption that the parties to a bargain always act rationally. Our model acknowledges that people make behavioral decisions partially in response to social norms.[370] Also, as in Rawls's hypothetical original position, the results under our unified model depend in part on the assumptions one makes about the degree to which people are risk averse or risk neutral. We recognize that if lawmakers and judges applied our hybrid model to every dispute, the overall result might be a smaller gain in total social utility. Still, in general, the best test *ex post* of whether a bargain is fair and efficient is still whether *ex ante* the parties entered into the agreement willingly.

More importantly, our model is useful as a methodology for perceiving private law-making in a way that permits weight to be given to considerations of both fairness and efficiency. We believe the model may be especially useful in the examination of private agreements that raise fairness concerns where disparities exist in the bargaining power of the parties.[371] Thus, our model may be helpful for a court in considering

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369. *See* Eisenberg, *supra* note 61, at 746–47 (arguing that terms of contract made under conditions of perfect competition have strong claim to both fairness and efficiency).

370. *See supra* notes 309–20 and accompanying text.

371. Such as in "contracts of rescue," for example, as described by Buckley, who provides the following example:

> Anthony is an adventurous millionaire, whose travels have taken him to a remote desert. There his car breaks down, and he finds himself alone and very hungry. After a few days of wandering on foot, he comes across Conrad, a mercenary innkeeper. After questioning Anthony about his wealth, Conrad agrees to give Anthony food and lodging, and to help him return to civilization. In return, he demands all of Anthony's wealth. "Think about it for a few days," he tells Anthony.

Buckley, *supra* note 9, at 41.

For a discussion of such "contracts of rescue" from an economic perspective, see also William M. Landes & Richard A. Posner, *Salvors, Finders, Good Samaritans, and Other Rescuers: An Economic Study of Law and Altruism*, 7 J. Legal Stud. 83 (1978).

claims of unconscionability. In such cases, our unified model might not only temper efficiency with fairness, but also fairness with efficiency. Moreover, our model, as demonstrated above, has the capability of resolving a wide range of situations, including nuisance cases, condemnations, gratuitous promises, detrimental reliance, and restitution.

In summary, the modified Coasean model we propose retains as the normative principle the efficient maximization of total social welfare. But within our consensus model is included a modified Rawlsean redistributive principle. The redistribution results from constructive empathy that, depending on the circumstances, produces a social output at some point between the Posnerean "maximized total utility"[372] and what has been labeled the Rawlsean "maximin."[373] Whatever that output might be, we call it the "equitable gain" to distinguish it from either the maximin or the maximum result.

This equitable gain is predicated upon the interaction of three factors. First, legal rights, liabilities, and entitlements will be allocated in a manner designed to promote Pareto efficiency. Second, the most Pareto-efficient response in certain situations will be modified by the operation of constructive empathy resulting from the condition of hidden identity inserted into the Coasean model. The resulting constructive empathy will cause the otherwise Pareto-efficient result to be modified by a more equitable division of the surplus created by the bargain. Third, further compromises with efficiency maximization may result consequent to the social norm of perceived fairness in dividing the surplus utility. In short, our unified theory of justice is intended to accommodate and incorporate the normative ends of both efficiency and fairness.

The integrated model we propose is achievable through the insertion of a modified Rawlsean condition of hidden identity into the hypothetical Coasean efficiency paradigm. The condition of hidden identity, when combined with the social norm of risk aversion, produces a constructive empathy in the minds of all affected parties. This constructive empathy does not affect whether there will be a consensus, but, in certain situations associated with the perceived norm of fairness, it will affect the terms of the exchange. In summary, justice as efficiency and justice as fairness can live in harmony under our modified Rawlsean-Coasean model.

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372. *See supra* note 69.

373. *See supra* notes 68, 302.