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LAW AND ECONOMICS: REALISM OR DEMOCRACY?

HENRY E. SMITH*

Is law and economics anti-democratic? One hears complaints from many quarters that law and economics is a form of technocracy that cuts off legitimate debate and suppresses other important values that people hold dear.¹ On this view, law and economics privileges efficiency and focuses on quantifiable values to the exclusion of other, less measurable values that could have found expression through the political process. These concerns are central to debates in areas ranging from environmental protection to intellectual property. The irony in these complaints is that they are offered by commentators who are heirs of the legal realists, many of whom would in the same breath decry excessive formalism and applaud judicial sensitivity to policy. There may not be an inherent contradiction here, but there is a tension in practice.

Law and economics and democracy are not enemies, but I contend that legal realism—or its lingering aftershocks—causes

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1. See, e.g., William N. Eskridge, Jr. & Gary Peller, *The New Public Law Movement: Moderation as a Postmodern Cultural Form*, 89 MICH. L. REV. 707, 709 (1991) (noting the “technocratic tendencies of the law-and-economics right”); Duncan Kennedy, *Law-and-Economics from the Perspective of Critical Legal Studies*, in 2 THE NEW PALGRAVE DICTIONARY OF ECONOMICS AND THE LAW 465, 471 (Peter Newman ed., 1998) (criticizing law and economics commentators for “manipulating the apparently value neutral, technocratic discourse of efficiency to support their preferred outcomes”); Gary Minda, *The Jurisprudential Movements of the 1980s*, 50 OHIO ST. L.J. 599, 619 (1989) (“[L]aw and economics offers a new technocratic discourse to legitimize the universal perspective of mainstream legal thought.”); Robert Post, *The Challenge of Globalization to American Public Law Scholarship*, 2 THEORETICAL INQUIRIES L. 323, 325 (2001) (“Law and economics celebrates a narrow, reductionist, and technocratic focus on the formalization of means-ends relationships, which, in turn, has spurred the development of genuine expertise about the nature and consequences of legal rules. Law and economics has not been successful, however, with respect to forms of legal purposivism that resist such formal representation.”).

law and economics to be more technocratic and less democratic than necessary. While legal realism as a movement itself may be dead, it rules us from the grave. As the saying goes, “We are all realists now.”² There is nothing wrong with law-and-economics-inspired theories as theories—or with legal realism as a theory for that matter. Analyzing law and legal relations in their smallest parts and considering micro incentive effects (to the extent data is available) are worthy exercises, but without some sensitivity to institutional detail and competence, the tendency is to substitute the wisdom of the analyzing expert, especially in courts and agencies, for the collective wisdom emerging either from democracy or tradition.³

Many movements in legal thought draw on legal realism,⁴ and law and economics is no exception. Coase’s articles on the FCC⁵ and social cost⁶ are hyperrealist in their assumptions about property, especially in their adoption of the most extreme version of the bundle of rights conception of property.⁷ In the bundle of rights conception, property has no content on its own but instead emerges from policy-driven decisions about the actions that people might take.⁸ Things are merely a

2. E.g., LAURA KALMAN, *LEGAL REALISM AT YALE, 1927–1960*, at 229 (1986); Brian Leiter, *Rethinking Legal Realism: Toward a Naturalized Jurisprudence*, 76 *TEX. L. REV.* 267, 267 (1997) (“[A]s the cliché has it, . . . ‘we are all realists now.’”); Joseph William Singer, *Legal Realism Now*, 76 *CAL. L. REV.* 467, 467 (1988) (reviewing KALMAN (“All major current schools of thought are, in significant ways, products of legal realism. To some extent, we are all realists now.”)).

3. On the relation of legal realism to the technocratic ideal of early-twentieth-century Progressivism, see, for example, NEIL DUXBURY, *PATTERNS OF AMERICAN JURISPRUDENCE* 210–32 (1995). The “bundle of rights” approach in particular is identified with legal realism. See, e.g., Thomas W. Merrill & Henry E. Smith, *What Happened to Property in Law and Economics?*, 111 *YALE L.J.* 357 (2001); see also BRUCE A. ACKERMAN, *PRIVATE PROPERTY AND THE CONSTITUTION* 26–31, 97–103 (1977).

4. See Anthony Kronman, *Jurisprudential Responses to Legal Realism*, 73 *CORNELL L. REV.* 335 (1988).

5. R.H. Coase, *The Federal Communications Commission*, 2 *J.L. & ECON.* 1 (1959).

6. R.H. Coase, *The Problem of Social Cost*, 3 *J.L. & ECON.* 1 (1960).

7. See Merrill & Smith, *supra* note 3.

8. See, e.g., Thomas C. Grey, *The Disintegration of Property*, in *PROPERTY: NOMOS XXII* 69 (J. Roland Pennock & John W. Chapman eds., 1980); Edward L. Rubin, *Due Process and the Administrative State*, 72 *CAL. L. REV.* 1044, 1086 (1984) (“[P]roperty is simply a label for whatever ‘bundle of sticks’ the individual has been granted.”); Joan Williams, *The Rhetoric of Property*, 83 *IOWA L. REV.* 277, 297 (1998) (“Labeling something as property does not predetermine what rights an owner does or does not have in it.”); see also J.E. Penner, *The “Bundle of Rights” Picture of Property*, 43

backdrop to this fine-grained analysis of potentially conflicting activities, and rights to exclude from things have no particular status as a starting point.

These assumptions were understandable in light of Coase's goal of demonstrating that, in a world of positive transaction costs, it matters how entitlements are assigned. But when it comes to using Coase's insights, his hyperrealist assumptions have been allowed to steal the show.⁹ In Coase's analysis of nuisance, we expect judges to figure out *ex post* which of the conflicting parties should be awarded each stick in the bundle of rights.¹⁰ And in making these decisions, the questions of "who invaded what" or "who caused what to whom" do no work at all.¹¹ In contrast to traditional and everyday notions of property as a right to things that is good against the world, Coasean agnosticism about causation leads one to see both the trampling animals and the trampled-upon crops as the cause of conflict. And under this conception, one is to ask whether fists or noses cause punches, or, for that matter, which are the cheapest cost avoiders.¹² None of this accords with non-economic intuition.¹³ Although causal agnosticism is a useful theoretical con-

UCLA L. REV. 711, 733–38 (1996) (discussing various approaches to the "bundle of rights" perception of property).

9. See Henry E. Smith, *Exclusion and Property Rules in the Law of Nuisance*, 90 VA. L. REV. 965, 978 n.33 (2004) [hereinafter Smith, *Exclusion and Property Rules*] (citing Merrill & Smith, *supra* note 3, at 366–75); Henry E. Smith, *Modularity in Contracts: Boilerplate and Information Flow*, 104 MICH. L. REV. 1175, 1178 (2006).

10. For the article that launched a thousand analyses in this vein, see Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972).

11. For recent analyses from a variety of perspectives that try to bring the more traditional invasion-based test back to the fore, see, for example, Richard A. Epstein, *Nuisance Law: Corrective Justice and Its Utilitarian Constraints*, 8 J. LEGAL STUD. 49, 53–65 (1979); J.E. Penner, *Nuisance and the Character of the Neighbourhood*, 5 J. ENVTL. L. 1, 14–25 (1993); Smith, *Exclusion and Property Rules*, *supra* note 9, at 992–96; Eric R. Claeys, *Jefferson Meets Coase: Land-Use Torts, Law and Economics, and Natural Property Rights* (George Mason Law & Economics Research Paper No. 08-20, 2008), available at <http://ssrn.com/abstract=1117999>.

12. See, e.g., GUIDO CALABRESI, *THE COSTS OF ACCIDENTS: A LEGAL AND ECONOMIC ANALYSIS* 135–73, 261–63 (1970); Guido Calabresi & Jon T. Hirschoff, *Toward a Test for Strict Liability in Torts*, 81 YALE L.J. 1055, 1060 (1972); Harold Demsetz, *When Does the Rule of Liability Matter?*, 1 J. LEGAL STUD. 13, 27–28 (1972).

13. See Donald H. Gjerdingen, *The Coase Theorem and the Psychology of Common-Law Thought*, 56 S. CAL. L. REV. 711, 724–25 (1983); Thomas W. Merrill & Henry E. Smith, *The Morality of Property*, 48 WM. & MARY L. REV. 1849, 1860–66 (2007) [hereinafter Merrill & Smith, *The Morality of Property*]; Merrill & Smith, *supra* note 3, at 391–94; see also MARK KELMAN, *A GUIDE TO CRITICAL LEGAL STUDIES* 68–69, 118–19 (1987) (criti-

struct and fine as far as it goes, it does not go very far: for transaction-cost reasons—not to mention basic moral reasons—causation is unidirectional. We have made *ex ante* decisions about what counts as an invasion,¹⁴ and absent good reasons—and sometimes good reasons exist—we should stick to those decisions.

Now it might be thought that this technocratic tendency in fine-grained analysis is specific to property. Such a view seems unlikely when we consider that Coase and many of the bundle theorists are basically treating property as dissolving into torts. Echoes of this are to be found in current debates over intellectual property, in which skeptics of intellectual property would like to see more of a tort or regulatory regime than a property regime in IP.¹⁵ In any case, the legal realist strand that became law and economics tackled torts relatively early,¹⁶ and torts has featured much more largely in law and economics scholarship than has property proper. Torts seems tailor-made for the type of technical approach that legal realist-style law and economics offers. This Essay, therefore, will concentrate on torts and argue that even here, on the best terrain for legal realist law and economics, the technocratic tendency has led to similar, if less dramatic, results.

A word about technocracy and democracy is in order. I am using “democracy” and “technocracy” in a special sense, one in which they potentially conflict. In arguing against “technocracy” I am not opposing well-informed decision making of all sorts. Instead, I am making the narrower point that modes of legal decision making that ask judges to use a great deal of con-

cizing transaction-cost analysis of questions of entitlement not to be raped and noting the role of reciprocal view of causation); A.W. Brian Simpson, *Coase v. Pigou Reexamined*, 25 J. LEGAL STUD. 53, 60 (1996) (“[O]nce the reciprocal nature of the problem is conceded, there is just no end to the possibilities The reciprocal nature of human interaction can raise emotive issues, as when women object to the idea that the way to stop sexual assaults on the streets at night is for them to stay at home. Even if they are the cheapest cost avoiders, ought this to be conclusive?”).

14. See, e.g., *Jacque v. Steenberg Homes, Inc.*, 563 N.W.2d 154 (Wisc. 1997) (refusing to consider actual damage caused or reasonableness of landowner’s refusal of entry); Smith, *Exclusion and Property Rules*, *supra* note 9, at 990–1021.

15. See Henry E. Smith, *Intellectual Property as Property: Delineating Entitlements in Information*, 116 YALE L.J. 1742, 1755–61 (2007).

16. See, e.g., Edward L. Rubin, *The Nonjudicial Life of Contract: Beyond the Shadow of the Law*, 90 NW. U. L. REV. 107, 112 (1995) (“[T]he early work in law and economics involved torts and regulatory programs . . .”).

textual information have their inherent limits. The argument is based on the presence of information costs, a limit that could be regarded as “technocratic,” but in a different sense. The information cost argument here is at a meta level: In evaluating a system of decision making, one might want to use all available information and techniques, even if these reveal limits, *within* the system, on our ability to use information.

In other words, I am making a meta-level, realist-style argument for a certain degree of formalism in ordinary legal decision making, where formalism is (relative) invariance to contextual information.¹⁷ By contrast, combating formalism and thereby disregarding these limits to the use of contextual information is quite characteristic of legal realism in practice. Law and economics is only one branch of the tree whose trunk is legal realism proper, and many of the criticisms of thoroughgoing antiformalism apply to these other approaches as well. But today’s topic is law and economics, and more particularly antiformalist post-realist law and economics. Unconstrained contextual decision making tends to put more power in the hands of decision makers within the system—often unelected judges in the case of the common law—and this power tends to conflict with democracy to the extent that such decisions are difficult to reverse in the political process. Moreover, the information cost considerations for which I argue tend to point towards greater reliance on everyday morality, associated with the people, generally. Highly refined all-things-considered utilitarian decision making tends to conflict both with this popular morality and the congruent, more modest decision making that can be economically justified at the higher, systemic level.

There is nothing inherent in analyzing legal relations at the systemic level that would necessarily lead to technocracy, so it is worth considering why law and economics, and the economic analysis of torts in particular, partakes so heavily in those aspects of legal realism that emphasize expert decision making.

Like some strands of legal realism, the economic analysis of torts tends to emphasize, if not elevate, the role of the judge.

17. See Francis Heylighen, *Advantages and Limitations of Formal Expression*, 4 FOUND. SCI. 25, 49–53 (1999). This approach to measuring linguistic formalism makes it a matter of degree, which is also true of formalism in law. See Henry E. Smith, *The Language of Property: Form, Context, and Audience*, 55 STAN. L. REV. 1105, 1167–90 (2003).

This elevation is somewhat ironic in light of the role of juries in tort law, as opposed to administrative decision making. The common law was fertile ground for the first generation of law and economics because bilateral interactions, including litigated disputes, are easier to model than the complex simultaneous interaction of many parties in taxation or regulation. Thus, in the sphere of primary actors, the bilateral impersonal tort-like conflict between the activities of *A* and *B*, or the more personal contract between *A* and *B*, make torts and contracts easier to understand than property, which is often about impersonal interactions between owners and the “rest of the world.” In property, multiple parties may have some claim on a single resource and multiple systems may overlap. Some interactions, such as the tragedy of the commons, were amenable to economic tools,¹⁸ but the bilateral interactions at the center of torts and contracts made these areas a top priority in law and economics. Further, in a world with zero transaction costs, solving every problem would be costless;¹⁹ it takes some effort to remember that the choice of analytical unit itself has transaction cost implications in the real world. Common-law litigation thus looks more amenable to economic analysis.

From there, it was a short step to focus on judicial decision making and, in older law and economics, the kinds of cost-benefit analysis that judges might undertake. When analyzing an interaction, the *benefits* of fine grain are apparent—they are the point of the exercise—but the *costs* are less apparent. True, any analysis should take “administrative costs” into account. But as is quite apparent with the bundle of rights, the cheap-

18. See, e.g., Steven N.S. Cheung, *The Structure of a Contract and the Theory of a Non-Exclusive Resource*, 13 J.L. & ECON. 49, 64 (1970); H. Scott Gordon, *The Economic Theory of a Common-Property Resource: The Fishery*, 62 J. POL. ECON. 124 (1954); Jens Warming, *Aalgaardsretten*, 69 NATIONALÖKONOMISK TIDSSKRIFT 151 (1931); Jens Warming, *Om “Grundrente” af Fiskegrunde*, 49 NATIONALÖKONOMISK TIDSSKRIFT 495 (1911), translated in Peder Anderson, “On Rent of Fishing Grounds”: A Translation of Jens Warming’s 1911 Article, with an Introduction, 15 HIST. POL. ECON. 391 (1983); see also Garrett Hardin, *The Tragedy of the Commons*, 162 SCIENCE 1243, 1244 (1968) (popularizing Gordon’s analysis, adopting the label “tragedy of the commons,” and employing the misleading example of grazing commons). The basic intuition of the tragedy of the commons can be found in ARISTOTLE, *THE POLITICS AND THE CONSTITUTION OF ATHENS* 33 (Stephen Everson ed., Benjamin Jowett trans., 1996) (“[T]hat which is common to the greatest number has the least care bestowed upon it. Everyone thinks chiefly of his own, hardly at all of the common interest.”).

19. See Coase, *supra* note 6.

ness of the baseline *in rem* right to exclude is easy to overlook. In the case of property, the convenience of the baseline stems in part from the diffuse nature of the processing costs. To the extent that these benefits of the baseline inhere in the system as a whole and are usually left implicit, they are especially easy to ignore in fine-grained analysis that puts a premium on articulated rationality.

It is somewhat ironic that law and economics overlooks the system-wide benefits of simplicity, because economists have long known that global systems show significant local variation. Partial equilibrium and general equilibrium are two very different things. Law and economics rarely rests on a general equilibrium analysis. But partial analyses must be taken with a grain of salt; it is characteristic of complex systems that a subpart may not share properties with the whole.²⁰ Similarly, the theory of the second best warns that when distortions are present, fewer distortions are not necessarily better, because one distortion might be offsetting another.²¹ Again, in the case of law, to the extent that benefits inhere in a system as a whole, as opposed to its constituent rules, doctrines, or decisions, those benefits are easy to overlook. Although the first-generation arguments about the efficiency of the common law are harder to maintain now,²² the analysis of law in terms of the desirability

20. See HERBERT A. SIMON, *THE SCIENCES OF THE ARTIFICIAL* 195 (2d ed. 1981) (1969).

21. See R. G. Lipsey & Kevin Lancaster, *The General Theory of the Second Best*, 24 *REV. ECON. STUD.* 11 (1956–57).

22. Compare George L. Priest, *The Common Law Process and the Selection of Efficient Rules*, 6 *J. LEGAL STUD.* 65 (1977) (arguing for a tendency of efficient legal rules to become dominant because inefficient rules will be litigated more often), and Paul H. Rubin, *Why is the Common Law Efficient?*, 6 *J. LEGAL STUD.* 51 (1977) (arguing that access to courts encourages the development of efficient outcomes), with Vincy Fon & Francesco Parisi, *Litigation and the evolution of legal remedies: A dynamic model*, 116 *PUB. CHOICE* 419 (2003) (explaining why developments in law may be plaintiff friendly rather than purely efficient), William M. Landes & Richard A. Posner, *Adjudication as a Private Good*, 8 *J. LEGAL STUD.* 235, 284 (1979) (arguing that the common law does not automatically produce efficient rules, but that there are areas in which the tendency to produce efficient rules can be predicted on economic grounds), Richard O. Zerbe, Jr., *Justice and the Evolution of the Common Law*, 3 *J.L. ECON. & POL'Y* 81 (2006) (suggesting that the trend towards efficiency is really a result of seeking justice), and Todd J. Zywicki, *The Rise and Fall of Efficiency in the Common Law: A Supply-Side Analysis*, 97 *NW. U. L. REV.* 1551 (2003) (arguing that now-abandoned competition between courts once promoted efficiency of the common law but no longer). In part this question turns on a view of the inputs and criteria for judicial decision making. Compare RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 322 (1972) (As in the market, "it is primarily the criterion of efficiency rather

of individual rules stacks the deck against the basic baselines from which they may depart. This is clear in property, but I will argue that this problem arises in torts as well.²³

The micro focus on individual rules also skews analysis towards the rules and the *ex ante* perspective. Indeed, legal realism—along with law and economics—is of two minds about the *ex ante* versus *ex post* perspective. Law and economics in particular is concerned with incentives for the future and is *ex ante* in this sense.²⁴ But like legal realism more generally, law and economics is not *ex ante* in another very important way. Neither legal realism nor its offshoot in conventional law and economics take seriously the idea of preexisting legal baselines. In areas like property we have made some fairly robust decisions about who has rights against whom, and these decisions are not to be lightly cast aside when someone comes along with a new efficiency analysis. Although it is true that the need for stability in the basic package of rights can be analyzed in economic terms, the tendency in law and economics, as it is practiced in law schools and on the bench, is often to allow economic analysis to drive very low-level decisions about individual rules.²⁵

This eagerness to apply economics to individual rules has a vaguely Benthamite or technocratic cast.²⁶ Actually labeling all

than of distributive justice that guides decision.”), with James E. Krier, Book Review, 122 U. PA. L. REV. 1664, 1695 (1974) (reviewing POSNER, *supra*) (questioning this view), and Arthur Allen Leff, *Economic Analysis of Law: Some Realism About Nominalism*, 60 VA. L. REV. 451 (1974) (reviewing POSNER, *supra*) (analogizing Posnerian efficiency to a character in a picaresque novel).

23. The issue of the particularity with which courts should address questions like duty in torts also arises in a corrective justice approach as well. See, e.g., W. Jonathan Cardi & Michael D. Green, *Duty Wars*, 81 S. CAL. L. REV. 671 (2008); Dilan A. Esper & Gregory C. Keating, *Abusing “Duty,”* 79 S. CAL. L. REV. 265 (2006); Dilan A. Esper & Gregory C. Keating, *Putting “Duty” in its Place: A Reply to Professors Goldberg & Zipursky*, 41 LOY. L.A. L. REV. (forthcoming 2008), available at <http://ssrn.com/abstract=1138340>; John C.P. Goldberg & Benjamin C. Zipursky, *Shielding Duty: How Attending to Assumption of Risk, Attractive Nuisance, and Other “Quaint” Doctrines Can Improve Decisionmaking in Negligence Cases*, 79 S. CAL. L. REV. 329 (2006).

24. For examples of commentary characterizing law and economics as *ex ante*, see Richard R.W. Brooks & Warren F. Schwartz, *Legal Uncertainty, Economic Efficiency, and the Preliminary Injunction Doctrine*, 58 STAN. L. REV. 381, 391–92 (2005); Nathan Oman, *Unity and Pluralism in Contract Law*, 103 MICH. L. REV. 1483, 1492 (2005).

25. For an overview with an emphasis on property, see Merrill & Smith, *supra* note 3, at 375–97.

26. Although Bentham himself was a proponent of property, see, for example, JEREMY BENTHAM, *THE THEORY OF LEGISLATION* 109–22 (C.K. Ogden ed., Harcourt, Brace & Co. 1931) (1802) (emphasizing property’s role in securing “the expectation

this Benthamite is somewhat ironic because Bentham was no fan of judges and the common law.²⁷ Nonetheless, the progress-oriented faith in articulated rationality and a narrow utilitarianism coupled with disregard for traditions make much of mainstream law and economics and its progeny thoroughly Benthamite. Indeed the legal realists found Bentham mostly congenial for similar reasons.²⁸

By contrast, traditional notions of property rest on a base of everyday morality.²⁹ In property, core rights to exclude, backed up by norms and laws against trespass and theft, command widespread support. Only at the edges, where nuisance and regulations like zoning concern high-stakes specialized problems not amenable to the exclusion approach do we find another kind of morality of balancing that is more consistent with the type of analysis common in realist-inspired law and economics.³⁰ On certain dramatic occasions, as in the recent decision in *Kelo v. City of New London*,³¹ there is a conflict between scientific policy making and the core moral sense of property, a sense that has tradition, and more recently democratic action, behind it.³² Thus it is the low-level utilitarianism, which characterizes much of law and economics, that lends it a vaguely technocratic cast. By breaking law down into individual rules and holding these up to the light of articulated rationality, law and economics deemphasizes everyday notions of morality that find their expression in tradition and democratic decision making.

of deriving certain advantages from a thing . . . in consequence of the relation in which we stand towards it"); Jeremy Bentham, *Principles of the Civil Code*, in 1 THE WORKS OF JEREMY BENTHAM (John Bowring ed., London, Simpkin Marshall & Co. 1843) (warning the attacks on property would result in the destruction of incentives to work), his disdain for tradition and penchant for scientific policymaking commended him to the realists. See *infra* note 28 and accompanying text.

27. See, e.g., Jeremy Bentham, *Rationale of Judicial Evidence*, in 6 THE WORKS OF JEREMY BENTHAM 204–05 (John Bowring ed., Russell & Russell Inc. 1962) (1827) (criticizing the common law of evidence and proposing legislative, not judicial, improvements). See generally JEREMY BENTHAM, A FRAGMENT ON GOVERNMENT (London 1776).

28. See Merrill & Smith, *The Morality of Property*, *supra* note 13, at 1868–69. Early on Roscoe Pound's main problem with Bentham was that Bentham was not radical enough in challenging prevailing notions of individualism. See ROSCOE POUND, THE SPIRIT OF THE COMMON LAW 158–61 (1921).

29. See Merrill & Smith, *The Morality of Property*, *supra* note 13.

30. See *id.* at 1890–94.

31. 545 U.S. 469 (2005).

32. See Merrill & Smith, *The Morality of Property*, *supra* note 13, at 1879–84.

One might think that torts is the common law area ideally suited to the type of law and economics this Essay criticizes and that some form of legal realism is really the only coherent way to think about torts. There is, however, some suggestive evidence to the contrary. Although this is not the time or place to compare utilitarian and corrective justice theories of torts, law and economics in a non-realist—or not exclusively realist—spirit is not only possible but desirable.

Economic analysis has tended to ignore baselines in those parts of torts that are the closest to property. Take, for example, nuisance law. According to authorities like the *Restatement (First) of Torts* and much of law and economics, nuisance is an exercise in balancing and looks like regulation writ small.³³ This approach misses important aspects of nuisance.³⁴ First, much—though not all—of nuisance is indeed about invasions: who caused what waves or particles to cross a boundary to the

33. See RESTATEMENT (FIRST) OF TORTS §§ 822, 826 (1939); see also RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 62 (6th ed. 2003) (“The alternative to absolute rights is balancing, and is the approach taken by the most important common law remedy for pollution, which is nuisance, the tort of interference with the use or enjoyment of land. The standard most commonly used for determining nuisance is *unreasonable* interference, which permits a comparison between (1) the cost to the polluter of abating the pollution and (2) the lower of the cost to the victim of either tolerating the pollution or eliminating it himself. This is an efficient standard . . .”); WILLIAM L. PROSSER, *HANDBOOK OF THE LAW OF TORTS* § 89 at 596 (4th ed. 1971) (citing cases). Under the *Restatement (Second)*, a nuisance is a significant nontrespassory invasion of use and enjoyment of land that is caused by either intentional and unreasonable activities or by negligent, reckless, or abnormally dangerous activities. RESTATEMENT (SECOND) OF TORTS §§ 821F, 822 (1979). Intentional nuisances largely turn on reasonableness:

An intentional invasion of another’s interest in the use and enjoyment of land is unreasonable if

- (a) the gravity of the harm outweighs the utility of the actor’s conduct, or
- (b) the harm caused by the conduct is serious and the financial burden of compensating for this and similar harm to others would not make the continuation of the conduct not feasible.

Id. § 826; see also *id.* § 827 (setting out factors relating to gravity of the harm, including the social value of the plaintiff’s use); *id.* § 828 (setting out factors relating to utility of actor’s conduct, including its social value); see also 6-A *AMERICAN LAW OF PROPERTY* § 28.22, at 66, § 28.26, at 75–77 (A. James Casner ed., 1954) (emphasizing the vagaries associated with, and importance of, a determination as to whether a defendant’s conduct is unreasonable); 1 *FOWLER V. HARPER & FLEMING JAMES, JR., THE LAW OF TORTS* § 1.24, at 70–74 (1956) (discussing the importance of reasonableness consideration in nuisance cases).

34. See Smith, *Exclusion and Property Rules*, *supra* note 9.

disturbance of the owner.³⁵ Further, some nuisances are nuisances per se;³⁶ when a noise is loud enough, for example, one simply does not need to know about context.

Moreover, the notion of invasion piggybacks on basic entitlements. The whole notion in the scheme of property rules and liability rules that “we” need to “decide” whether *A* or *B*, resident or polluter, “gets” the “entitlement” does great violence to the basic package of rights in land.³⁷ That package includes a right to exclude,³⁸ a right to which for some purposes we might make exceptions or of which we might weaken the protection (from injunction to damages).³⁹ But it does not include a “right to pollute.”⁴⁰ One might get away with pollution, but the put-upon neighbor is allowed to blow the smoke back. Or one might have an easement which would be a right to pollute but which is definitely not part of the default package of rights. In its enthusiasm for breaking legal relations down into interesting analytical bits and discovering intriguing symmetries, the economic approach to nuisance, and by extension other torts, often disregards the asymmetry built into *ex ante* baselines of property rights.⁴¹ This is true of rights to bodily integrity and rights to land or chattels. Again, we do not think in terms of reciprocity of causation for assaults.

More generally, the enthusiasm for liability rules over property rules flows from the technocratic impulse in law and economics. Sophisticated arguments for ever more complex liability rules overlook the virtues of simple baselines that also

35. See *id.* at 990–1007.

36. See, e.g., *Morgan v. High Penn Oil Co.*, 77 S.E.2d 682, 687 (N.C. 1953); Smith, *Exclusion and Property Rules*, *supra* note 9, at 998 & n.100.

37. See Henry E. Smith, *Self-Help and the Nature of Property*, 1 J.L. ECON. & POL'Y 69, 70–80 (2005).

38. See, e.g., *Kaiser Aetna v. United States*, 444 U.S. 164, 176 (1979) (characterizing the right to exclude others as “one of the most essential sticks in the bundle of rights that are commonly characterized as property”).

39. See, e.g., Smith, *Exclusion and Property Rules*, *supra* note 9, at 973.

40. *Id.* at 1011–16.

41. See, e.g., Lee Anne Fennell, *Property and Half-Torts*, 116 YALE L.J. 1400, 1404 n.10 (2007); Frank I. Michelman, *There Have To Be Four*, 64 MD. L. REV. 136, 147–52 (2005) (discussing asymmetries in “remedial entailments” in the C&M framework); Jeanne L. Schroeder, *Three's a Crowd: A Feminist Critique of Calabresi and Melamed's One View of the Cathedral*, 84 CORNELL L. REV. 394, 433–35 (1999); Smith, *Exclusion and Property Rules*, *supra* note 9, at 1019–21; Smith, *supra* note 37, at 72–76.

accord with everyday morality.⁴² To be sure, in situations of high transaction costs, it is worth considering liability rules, but even where the conventional wisdom would strongly favor liability rules, as in large-scale pollution by a factory employing many people,⁴³ the tendency in fine-grained utilitarian law and economics is to grasp much too quickly for liability-rule solutions. By contrast, recently some have argued that even the classic *Boomer* opinion was too quick to shift from injunctions to damages.⁴⁴ Even in high transaction cost situations, property and property rules should have some presumptive force, and especially in cases of deliberate, high-stakes violations, we should require the prospectively invading party to justify its selection of site in a hearing beforehand (and perhaps post a bond), as is typical of Mill Acts and limited private eminent domain statutes, rather than causing a *fait accompli*.⁴⁵ In other

42. See, e.g., IAN AYRES, *OPTIONAL LAW: THE STRUCTURE OF LEGAL ENTITLEMENTS* (2005); Ronen Avraham, *Modular Liability Rules*, 24 INT'L REV. L. & ECON. 269 (2004) (advocating multiple-option liability rules); Ian Ayres & J.M. Balkin, *Legal Entitlements as Auctions: Property Rules, Liability Rules, and Beyond*, 106 YALE L.J. 703, 711 (1996) (noting that higher-order liability rules with ascending damages on successive takings create auctions); Ian Ayres & Paul M. Goldbart, *Correlated Values in the Theory of Property and Liability Rules*, 32 J. LEGAL STUD. 121, 121–26 (2003) (discussing higher-order rules and showing how allowing for multiple prices can never do worse than other rules, but alluding to practical problems with implementation); Lee Anne Fennell, *Revealing Options*, 118 HARV. L. REV. 1399 (2005); Saul Levmore, *Unifying Remedies: Property Rules, Liability Rules, and Startling Rules*, 106 YALE L.J. 2149, 2152 (1997).

43. See, e.g., *Boomer v. Atl. Cement Co.*, 257 N.E.2d 870 (N.Y. 1970). For support for liability rules in situations of high transaction costs, see, for example, ROBERT COOTER & THOMAS ULEN, *LAW AND ECONOMICS* 170–71, 175–81 (1988) (noting problem and suggesting damages as solution), RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 16, 68–69, 79–81 (5th ed. 1998) (same), Calabresi & Melamed, *supra* note 10, at 1106–10 (same), and James E. Krier & Stewart J. Schwab, *Property Rules and Liability Rules: The Cathedral in Another Light*, 70 N.Y.U. L. REV. 440, 452 & n.44 (1995) (describing survey of legal literature from 1975 to 1986 in which some dozen proposals for liability rules in high transaction costs settings were proposed, and giving examples).

44. See Daniel A. Farber, *Reassessing Boomer: Justice, Efficiency, and Nuisance Law*, in *PROPERTY LAW AND LEGAL EDUCATION: ESSAYS IN HONOR OF JOHN E. CRIBBET* 7, 7–8 (Peter Hay & Michael H. Hoeflich eds., 1988); Smith, *Exclusion and Property Rules*, *supra* note 9, at 1037–45; Henry E. Smith, *Property and Property Rules*, 79 N.Y.U. L. REV. 1719, 1733–34 & n.44 (2004) [hereinafter Smith, *Property and Property Rules*]. Also, when multiple plants are involved, liability rules are problematic, and property-like solutions involving tradable permits may become preferable. See Carol M. Rose, *The Shadow of The Cathedral*, 106 YALE L.J. 2175, 2193–96 (1997).

45. See, e.g., Richard A. Epstein, *A Clear View of The Cathedral: The Dominance of Property Rules*, 106 YALE L.J. 2091, 2114 (1997); John F. Hart, *Land Use Law in the Early*

words, if we are to have private eminent domain, it should come with due process safeguards at least as stringent, if not more so, than those to which we subject exercises of public eminent domain.

The “Boomer problem” has also been taken as support for a version of behavioral law and economics in which ordinary actors’ decision making is interpreted as distorted by biases and heuristics.⁴⁶ Might property rule protection lead to a greater endowment effect than liability rules? In a recent paper, Rachlinski and Jourden find that experimental subjects show a greater gap between willingness to accept and willingness to pay for entitlements protected by property rules than those protected by liability rules, and the authors interpret this as an example of the endowment effect preventing efficient negotiation.⁴⁷ To address

Republic and the Original Meaning of the Takings Clause, 94 NW. U. L. REV. 1099, 1116 (2000); Smith, *Exclusion and Property Rules*, *supra* note 9, at 1042–43; *see also* Act of July 3, 1868, ch. 20, § 3, 1868 N.H. Laws 152, 152–53; *Head v. Amoskeag Mfg. Co.*, 113 U.S. 9, 10 n.* (1885) (quoting the New Hampshire Act of July 3, 1868). For examples of the ex ante protections under private eminent domain statutes, *see*, for example, IDAHO CODE ANN. § 42-1106 (2003) (“In case of the refusal of the owners or claimants of any lands, through which any ditch, canal or conduit is proposed to be made or constructed, to allow passage thereof, the person or persons desiring the right of way may proceed as in the law of eminent domain.”); WYO. STAT. ANN. § 24-9-104 (2003) (“Upon the presentation of a petition signed by at least five (5) freeholders of any neighborhood, praying for passage to any watercourse for the purpose of watering livestock, or for the convenient access to timber, the board of county commissioners may, in their discretion, establish such water or timber way as provided in W.S. 24-9-101 through 24-9-103 relating to the opening of private roads.”).

46. On the endowment effect, *see* Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325 (1990) (arguing that endowment effects persist even in market settings where participants have opportunities to learn), Daniel Kahneman & Amos Tversky, *Prospect Theory: An Analysis of Decision Under Risk*, 47 ECONOMETRICA 263 (1979) (discussing basics of prospect theory), Jack L. Knetsch, *The Endowment Effect and Evidence of Nonreversible Indifference Curves*, 79 AM. ECON. REV. 1277 (1989) (reporting tests demonstrating endowment effect), and Amos Tversky & Daniel Kahneman, *Loss Aversion in Riskless Choice: A Reference-Dependent Model*, 106 Q.J. ECON. 1039 (1991) (presenting theoretical explanation for endowment effect based on loss aversion). For a sympathetic summary of work in this area, *see* RICHARD H. THALER ET AL., *The Endowment Effect, Loss Aversion, and Status Quo Bias*, in THE WINNER’S CURSE: PARADOXES AND ANOMALIES OF ECONOMIC LIFE 63–78 (1992). For some recent challenges to the interpretation of experiments in terms of prospect theory, *see* Charles R. Plott & Kathryn Zeiler, *Exchange Asymmetries Incorrectly Interpreted as Evidence of Endowment Effect and Prospect Theory?*, 97 AM. ECON. REV. 1449 (2007), and Charles R. Plott & Kathryn Zeiler, *The Willingness to Pay–Willingness to Accept Gap, the “Endowment Effect,” Subject Misconceptions, and Experimental Procedures for Eliciting Valuations*, 95 AM. ECON. REV. 530 (2005).

47. Jeffrey J. Rachlinski & Forest Jourden, *Remedies and the Psychology of Ownership*, 51 VAND. L. REV. 1541, 1566–72 (1998).

ecological validity they examine *Boomer* through the lens of behavioral decision theory; they interpret the behavior of the plaintiffs in *Boomer* as also reflecting the endowment effect rather than subjective value, on the grounds that the plaintiffs did not appeal the size of the damage award or ask for higher-than-market damages.⁴⁸ But the likely reason for the plaintiffs' failure to do so is not the endowment effect, but rather that under the law of nuisance, injunctions are available but supracompensatory damages are not.⁴⁹

All this is familiar territory and vaguely property related. Another suggestive example of how the conventional rule-by-rule approach misses something that is captured in a more holistic appreciation of traditional baselines is the "economic loss" rule in torts.⁵⁰ As its name suggests, it should be amenable to economic analysis. And sure enough, there has been no dearth of speculative analysis about why courts apparently deny recovery in negligence for harm where there is only pure economic loss—no injury to person or property.⁵¹ Rationales boil down to a pragmatic sense that applying negligence to all economic loss would lead to indeterminate and open-ended liability.⁵² In keeping with current trends, the economic loss rule in the courts is now being studied empirically as well, revealing how many exceptions there are and, at

48. See *id.* at 1543–44.

49. See Henry E. Smith, *Property and Property Rules*, *supra* note 44, at 1771–72; see also *Boomer v. Atl. Cement Co.*, 257 N.E.2d 870, 874–75 (N.Y. 1970) (discussing damages available and referring to diminution in objective value); W. PAGE KEETON ET AL., PROSSER AND KEETON ON THE LAW OF TORTS § 89, at 637–40 (5th ed. 1984) (discussing types of damages available to nuisance plaintiffs, including diminution in market value and, under some circumstances, special damages, but not damages for subjective value).

50. See, e.g., *Robins Dry Dock & Repair Co. v. Flint*, 275 U.S. 303 (1927) (Holmes, J.); *Ultramares Corp. v. Touche*, 174 N.E. 441 (N.Y. 1931) (Cardozo, J.). See generally DAN B. DOBBS, THE LAW OF TORTS § 452 (2001).

51. See, e.g., W. Bishop, *Economic Loss in Tort*, 2 OXFORD J. LEGAL STUD. 1 (1982); Victor P. Goldberg, *Recovery for Economic Loss Following the Exxon Valdez Oil Spill*, 23 J. LEGAL STUD. 1 (1994); Richard A. Posner, *Common-Law Economic Torts: An Economic and Legal Analysis*, 48 ARIZ. L. REV. 735 (2006); Robert L. Rabin, *Tort Recovery for Negligently Inflicted Economic Loss: A Reassessment*, 37 STAN. L. REV. 1513 (1985).

52. See, e.g., Fleming James, Jr., *Limitations on Liability for Economic Loss Caused by Negligence: A Pragmatic Appraisal*, 25 VAND. L. REV. 43 (1972).

the same time, how no one can really say what the efficient rule is.⁵³

By contrast, in a recent, more doctrinally oriented analysis of the rule, Peter Benson shows that it is really quite simple: One can only recover from the tortfeasor if one has an *in rem* property right that has been violated.⁵⁴ Other lesser rights, such as a contract, are irrelevant to the tortfeasor. A good example comes from the classic *Robins* case:⁵⁵ If a ship is destroyed through the defendant's negligence, the ship owner can sue for the loss of the ship. The measure will be the market value of the ship. Someone who rented the ship cannot sue for the loss of his contract rights; he must sue the owner, who in turn can sue the tortfeasor.⁵⁶ But the allocation of the risks under the contract and the possible adoption of even greater risk by the owner—for example, if the owner warranted the ship for a particular purpose—are normally of no relevance to the outside world. Tort law deals with *in rem* dutyholders, and they are responsible for the standardized information that property law offers to the rest of the world. The opposite approach would allow contracting parties to impose a variety of hard-to-process duties on people at large. In this sense liability would be “excessive” or “unforeseeable,” but this is a much more specific sense than the way those terms are currently used by courts and commentators.

Thus, under the economic loss rule, recovery is only allowed to one who holds an *in rem* property right. Contractual and other relations between an owner and others are walled off and treated separately.⁵⁷ This makes sense on information cost grounds. Unfortunately, the kind of common-law reasoning that would get one there is an endangered species in

53. See Anthony Niblett et al., *The Evolution of a Legal Rule* (2008) (unpublished manuscript), available at <http://ssrn.com/abstract=1114941>.

54. See Peter Benson, *Economic Loss and the Prerequisites of Negligence* (Feb. 2008) (unpublished manuscript, on file with the University of Toronto).

55. *Robins*, 275 U.S. 303; see also Benson, *supra* note 54, at 15–39.

56. See *Robins*, 275 U.S. at 309.

57. This has the effect of preventing “ripple effects,” which are sometimes taken as a reason for the economic loss rule. See Robert L. Rabin, *Respecting Boundaries and the Economic Loss Rule in Tort*, 48 ARIZ. L. REV. 857, 862–64 (2006). Also, compartmentalizing information in the property rights keeps things simple, although in a different way than that recently proposed by Anita Bernstein. See Anita Bernstein, *Keep It Simple: An Explanation of the Rule of No Recovery for Pure Economic Loss*, 48 ARIZ. L. REV. 773 (2006).

American law schools—and evidently in America’s courtrooms as well.⁵⁸ This traditional approach was, despite the bad rap from the legal realists, neither incoherent nor necessarily less desirable than academics’ and judges’ familiar unstructured—and inconclusive—economic theorizing. Although it really is not possible without empirical evidence to say with any certainty whether the rule is efficient, one can point to a factor in its favor that typical academic law and economics analysis—and the more informal reasoning in judicial opinions—conspicuously leaves out: *in rem* property rights are designed to be broadcast to the world and have a simplicity and standardization that contract rights do not have. In other words, property rights are meant for an audience of impersonally interacting parties like potential tortfeasors.⁵⁹ How rights are internally carved up are idiosyncrasies that are internal to a deal and are not allowed to impose information costs on third parties.⁶⁰

Is the traditional approach efficient? It is hard to say. But the structure that emerges, in which the property, tort, and contract systems have defined spheres and interact in simple ways, has the indirect effect of making simple the incentives facing potential tortfeasors and making clear the baseline from which people contract. The traditional approach gives roughly correct incentives in an overall structure that is easy to use—for judges and for people in ordinary life. That is a big plus.

The possibility of often unelected judges being encouraged to cut huge swaths through the common law based on economic speculation of the most selective—and therefore discretionary—sort should give one pause. A certain amount of judicial modification of rules is necessary, but I have argued that existing baselines, especially core rights to exclude, deserve a presumptive force that they do not receive from legal realism or its

58. See Niblett et al., *supra* note 53.

59. See, e.g., Thomas W. Merrill & Henry E. Smith, *Optimal Standardization in the Law of Property: The Numerus Clausus Principle*, 110 YALE L.J. 1 (2000); Smith, *supra* note 17, at 1114, 1146–47, 1151.

60. In a more generalized setting, trusts and other entity property often allow *in personam* “internal” parties to allocate rights in resources among themselves in a way that the law keeps from being relevant *in rem* to outsiders. See THOMAS W. MERRILL & HENRY E. SMITH, PROPERTY: PRINCIPLES AND POLICIES 684–829 (2007); Thomas W. Merrill & Henry E. Smith, *The Property/Contract Interface*, 101 COLUM. L. REV. 773, 843–49 (2001).

offshoot in conventional law and economics. We do overcome these presumptions when making exceptions to exclusion rights (for example, for airplane overflights or necessity),⁶¹ and they are surrounded by fuzzier governance regimes like much of the law of nuisance.⁶² Nor is it easy to say how strong the presumption for these baselines should be; that is perhaps the central normative conflict in these areas of law. But a few tentative guidelines are possible.

In the light of these information cost considerations, when we can identify a situation in which legal innovation has occurred in a way that overturns a traditional rule with overlooked information cost advantages, we need to take a second look. Simplicity for third parties—as furnished by, for example, the economic loss rule—should strengthen the presumption for the rule. In general, where tort law implicates baselines furnished by property law, the reason for those baselines does not suddenly disappear. They need at least to be weighed against the considerations pointing to departure from them.

Second, the study of complex systems and cognitive psychology is beginning to make some of the traditional approach to custom and the common law look more attractive than it did to the realists.⁶³ With some exceptions the realists were positivistic and centralist.⁶⁴ Robert Ellickson and others have used economics to frame and test hypotheses about the importance of social norms and how they tend to be efficient within close-knit groups but may present wider externalities.⁶⁵ Information cost economics and cognitive science suggest some wisdom in

61. See, e.g., *United States v. Causby*, 328 U.S. 256 (1946); *Hinman v. Pac. Air Transp.*, 84 F.2d 755 (9th Cir. 1936); MERRILL & SMITH, *supra* note 60, at 9–15.

62. See Smith, *Exclusion and Property Rules*, *supra* note 9, at 973–75. For examples of scholarly comment on the “fuzzy” nature of nuisance law, see, for example, Daniel A. Farber, *The Story of Boomer: Pollution and the Common Law*, 32 *ECOLOGY L.Q.* 113, 117 (2005), and Carol M. Rose, *Property in All the Wrong Places?*, 114 *YALE L.J.* 991, 1006 (2005).

63. See Henry E. Smith, *Community and Custom in Property*, 10 *THEORETICAL INQUIRY L.* (forthcoming Jan. 2009), available at <http://ssrn.com/abstract=1142987>.

64. See, e.g., George Rutherford, *Custom and Usage as Action Under Color of State Law: An Essay on the Forgotten Terms of Section 1983*, 89 *VA. L. REV.* 925 (2003). Cf. MICHAEL J. SANDEL, *DEMOCRACY’S DISCONTENT: AMERICA IN SEARCH OF A PUBLIC PHILOSOPHY* 211–27 (1996) (finding both technocratic centralizing and decentralist strands in Progressivism).

65. See ROBERT C. ELICKSON, *ORDER WITHOUT LAW: HOW NEIGHBORS SETTLE DISPUTES* 167–206 (1991).

the common law's approach to the relation of custom and law. Judges had an intuitive sense—which can be explained and refined by economics—that custom is a danger if it binds those outside the community that originated the custom in question.⁶⁶ Besides consent—a democracy issue—community custom can impose high information costs on outsiders. Should the custom of hunters bind nonhunters? This is the question in *Pierson v. Post*.⁶⁷ Partly the desirability of applying such a custom more widely depends on whether nonhunters can or should be required to know the custom. In general, customs have been selected and formalized in the process of adoption in the common law. This judicial filtering is a necessary part of the process and can benefit from economic analysis. Nonetheless, the virtue of custom in the first place is that it is a partial substitute for a technocratic judicial analysis.

Finally, and more speculatively, the information cost virtues of traditional common law principles may point to a partial reconciliation of corrective justice and utilitarian approaches to tort law. Although this much-debated topic must be left for another day, note that corrective justice tends to reflect everyday morality that in the property context sensibly accommodates information cost.⁶⁸ Getting dutyholders to focus on intuitive and concrete harms to a well defined class of other parties has information cost advantages. If the information cost theory carries over from property to torts it may well be that the kind of everyday morality that has potential democratic support and the weight of tradition behind it can be rationalized on economic grounds. Such an economic approach to torts would be more democratic and more stable than the hyper-fine-grained utilitarianism and scientific policymaking in our post-legal realist law and economics as currently practiced.

In sum, as a branch of legal realism, law and economics has often cut out certain baselines that, subject to exceptions, have

66. See Smith, *supra* note 63.

67. 3 Cai. R. 175, 179 (N.Y. Sup. Ct. 1805).

68. For example, Arthur Ripstein's Kantian analysis of liability for apparently harmless trespass, Arthur Ripstein, *Beyond the Harm Principle*, 34 PHIL. & PUB. AFF. 215, 218 (2006), is consistent with both the current state of the law, *see, e.g.*, KEETON ET AL., *supra* note 49, § 13, at 75–77, and the prescriptions of an information cost theory of property, Smith, *Property and Property Rules*, *supra* note 44, at 1723–25; *see also* Merrill & Smith, *The Morality of Property*, *supra* note 13, at 1871–74.

the force of general consent and tradition behind them. A broader-gauged economic analysis that takes information costs into account suggests the wisdom in affording these baselines more presumptive force, even in an area as seemingly regulatory and activity-based as torts. In this way, rather than being a vehicle for overweening technocracy and therefore an enemy of democracy, law and economics can increase our appreciation for the information cost benefits of common-law starting points.