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## RULES AND REVERSIBILITY

*Clayton P. Gillette\**

### I. INTRODUCTION

Much of the value of legal rules evolves from their probabilistic nature. The fact that the factual predicate for a rule, to use Frederick Schauer's terms,<sup>1</sup> bears a probable causal relationship to the rule's justification means that we believe that in a substantial majority of the cases to which that rule is applied, i.e., presumptively, its application will advance a desired objective, and that it was in light of that objective that the rule was initially formulated. This relationship between the rule and some preferred outcome distinguishes legal rules from, for instance, the rules of a game that may simply be constitutive of the game and that might be altered without affecting the value of game playing (but that would mean a different game was being played). The value of the presumption lies in the fact that it advances the desired objective without requiring a more costly ad hoc application of the justification to the facts and consequences of individual cases. Legal rules thus serve as rough proxies or surrogates given either the inability or undesirability of defining or implementing a completely contingent specification of the circumstances that would lead us to regulate behavior. The presumptive nature of the rule indicates that there is some epistemic uncertainty about whether application of the rule will, in fact, vindicate its underlying justification in the individual case; indeed, the fact that the rule is only presumptive means that we are aware that strict application will occasionally generate undesirable results. But our reliance on rules suggests that the probability of the desired coincidence is sufficiently high to make more particularistic inquiries or more highly tailored formulations of the rule wasteful and to make the occasional losses that result from inappropriate application worth incurring.

That, at least, is the story we tell ourselves about the way in which legal rules operate. Thus, for instance, the ability of courts and legis-

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1 FREDERICK SCHAUER, *PLAYING BY THE RULES* 26-27 (1991).

latures to describe conditions that track the desired objective of the law underlies much of the literature comparing rules and standards. But relationships between factual predicates for rules and their justifications are not necessarily stable. The fact that a relationship exists at the time that the rule is first promulgated does not mean that the same relationship will be maintained throughout the period that the rule applies. That truism seems to pose little more than an inevitable difficulty for legal rules, as long as they are implemented in an environment that sufficiently permits decisionmakers to adjust them, just as claims of changed circumstances that disrupt contractual expectations occasionally permit adjustment of contractual terms.<sup>2</sup> At least in theory, there is little to prevent modification of legal rules when refinement is necessary to maintain the relationship between factual predicate and justification. Statutes can be amended to provide exceptions, to add safe harbors that reduce uncertainty about compliance,<sup>3</sup> or to redefine the conditions of liability or regulation. Courts can adjust both statutes and common law principles on an ad hoc basis in the face of circumstances deemed beyond the consideration of those who initially formulated the rule.<sup>4</sup>

The probabilistic nature of rules, however, becomes more problematic if there is something inherent in a rule that makes it difficult to reverse or revise, notwithstanding that it no longer reflects, or it is determined that it never accurately reflected, the relationship between its factual predicate and its justification. If we believed that rules were self-perpetuating in this manner, then we might have adjusted the initial statement of the rule in order to take into account the likelihood that the rule as stated could become both obsolete and inconsistent with its justification. The possibility that alternative formulations could prevent legal rules from becoming "locked in" is related to questions of institutional design that inhere in the formulation of legal rules. The less precisely rules are initially stated, the greater the room for judicial supervision of the fit between rules and their justification. As courts fill in the details of vague standards, they have inherent authority to determine whether particular sets of facts warrant application of the rule, and are likely to investigate the rule's purpose in making that determination. The more precisely legal rules are initially stated, however, the less room there is for judi-

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2 See, e.g., U.C.C. § 2-615 (1989).

3 See, e.g., Peter P. Swire, *Safe Harbors and a Proposal to Improve the Community Reinvestment Act*, 79 VA. L. REV. 349 (1993).

4 See, e.g., *Tedla v. Ellman*, 19 N.E.2d 987 (N.Y. 1939) (reading a customary exception into a statute that did not explicitly include it).

cial adjustment in the application of the rule. The result is that judges applying precise rules have little incentive to look behind the explicit terms of the provision to determine whether current conditions warrant its application. Indeed, as I shall argue below, certain formulations of legislatively drafted rules are intended to preclude judicial re-examination.

For instance, assume we believe that today the optimal speed limit for virtually all automobiles on highways is sixty miles per hour, but we foresee a time in the near future when improvements in the engineering of both automobiles and roads would allow safe driving at speeds up to eighty miles per hour. We might still pass a sixty mile per hour speed limit today, understanding that we would want to change it when the expected engineering advances actually occur. But if we believed there were institutional reasons why a statutory limit will become locked in once promulgated, but that courts might be better able to adjust to new information, then we might instead favor enactment today of a rule that required driving at a "reasonable" speed. This reformulation would reflect our confidence that shifting the decision about safe driving speeds from an *ex ante* analysis made by legislators to an *ex post* analysis by judges and juries would generate a more accurate series of decisions relating permissible driving speeds to safe driving speeds at any point in time, i.e., sixty miles per hour today, but eighty miles per hour in the future. In short, the possibility that rules may be difficult to reverse or revise should affect not only the substance of the rule, but the roles of different decisionmakers, particularly legislators and courts.

In this essay, I explore some situations in which the promulgation of a rule contains the seeds of its own preservation. I refer to the capacity of decisionmakers to revisit the probabilistic connection between the factual predicates for a rule and its justification as "reversibility," though I mean that term to include the capacity to revise, as well as reverse, prior formulations. To some extent, reversibility of rules depends on the weight that we assign to the presumptiveness of a rule. The more that the presumptive nature of a rule precludes the search for exceptions, the more difficult it may be to determine that reversal or revision is warranted. If we never look to determine whether conditions have changed, it is less likely that we will discover changes that have occurred. But I want to make a more subtle claim about the relationship between the probabilistic nature of rules and their reversibility. Legal rules, especially those based on presumptions, have multiple sources, and the source of a particular rule at least indirectly affects our ability to detect whether the factual predicates relied on for the initial articulation of the rule continue to apply.

The fact that a rule evolves from a particular source may mandate that rulemaking institutions, courts and legislatures, play discrete roles to ensure that the rule is drafted and implemented in a manner that is most likely to satisfy its objectives. Those same institutional roles, however, may preclude reinvestigation of the basis for the rule, even as they ensure its proper implementation, given the assumptions on which its initial articulation was based. Thus, my concern is primarily with the ways in which the sources of rules and the forms in which they are drafted define institutional arrangements that have the effect of frustrating reversal when rules have departed from their original probabilistic moorings.

## II. INSTITUTIONAL CONSERVATISM

My invocation of institutional design may be read to imply that the ultimate question to be addressed is whether courts or legislatures are ultimately more conservative, or whether one or the other is more likely to privilege the status quo. There are reasons to believe that each of these institutions bears systemic biases in favor of the status quo. The conservatism of courts is most apparent in the doctrine of stare decisis. Notwithstanding that the doctrine is sufficiently malleable to permit courts to avoid precedents when sufficient reasons are stated,<sup>5</sup> and even when they are not,<sup>6</sup> the assumption of stare decisis is that a prior decision will bind courts with respect to subsequent cases that are characterized by similar facts. We can, of course, debate the necessary realm of "similarity," but the fact remains that once courts following stare decisis find the case before them lies within that realm, they will not look for independent justifications of the decision they reach, but simply follow rules previously laid down. The existence of a doctrine that makes reinvestigation of existing legal doctrines unnecessary or inappropriate necessarily deters those who might otherwise advocate changes in legal rules and thus imposes a conservative structure on the legal regime.<sup>7</sup>

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5 The malleability of doctrine and the capacity of courts to make fine distinctions has been a hallmark of much of Fred Schauer's work. See, e.g., Frederick Schauer, *Precedent*, 39 STAN. L. REV. 571 (1987); Frederick Schauer, *Slippery Slopes*, 99 HARV. L. REV. 361, 370-73 (1985).

6 See Clayton P. Gillette, *The Path Dependence of the Law*, in THE LEGACY OF OLIVER WENDELL HOLMES (Steven Burton ed., forthcoming 1998).

7 This conclusion is not intended to suggest that stare decisis is itself inappropriate. Nor do I suggest that the law does not accommodate countervailing influences. For instance, contingent fees induce some attorneys to take high risk and high payoff cases, such as those that will be successful only if a change in the legal rule is announced. These inducements create a class of persons (often plaintiffs' lawyers) who

Stare decisis retards reversibility in an additional way, by reducing the incentives of those agents subject to the existing rule to initiate litigation in which courts might revisit the rule. Courts, unlike legislatures, do not initiate reforms on their own. Given that litigation is costly, litigants and litigators (at least, those who depend on contingent fees) are likely to incur those costs only when offset by expected benefits. Since stare decisis suggests that courts must follow existing law without independent justification, those who seek to overturn an existing rule must demonstrate both that the existing rule fails to track the underlying justification for it and that they should prevail under a new rule that better reflects the underlying justification. This additional burden decreases the possibility of success of any legal challenge, hence discouraging those who might otherwise initiate reforms. The public goods nature of legal rules, of course, enhances this effect, since potential litigants will obtain the same benefits without incurring the related costs should some other agent succeed in similar litigation. The result is that those who might benefit from a rule change in a system of stare decisis have some incentive to free ride on the efforts of others.

The conservatism of legislatures is more complicated. Once a rule has been enacted, it privileges particular groups that have incentives to maintain the status quo in order to retain those benefits. Of course, the same rule may disadvantage other groups that would prefer its reversal. Thus, one might think that each group would be successful in certain cases, but that, on balance, statutory law was neither inherently static nor subject to reversal. Nevertheless, legislatures will tend to avoid reversal of existing statutes for either of two reasons. The first reason stems from the psychological phenomenon of loss aversion. Individuals tend to value entitlements that they possess more highly than they value the same entitlement if they have not received it. Hence the value that one is willing to pay for a good or service will deviate from the value that the same individual is willing to accept as compensation for the loss of the same good or service.<sup>8</sup> We see this phenomenon in circumstances as wide-ranging as differential offer and asking prices for goods in robust markets to differentials in the judicial award of compensation for out-of-pocket losses and unrealized profits. In the legislative arena, this phenomenon should

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have an interest in overturning existing law. The current litigation campaign against cigarette manufacturers, who have, for the most part, avoided liability under existing legal rules governing product liability, may be a case in point.

8 See AMOS TVERSKY & DANIEL KAHNEMAN, *RATIONAL CHOICE* 62 (Robin M. Hogarth & Melvin W. Reder eds., 1986).

lead an interest group that has previously been granted a legislative benefit to bid more to retain that benefit than a competing group would be willing to bid to shift the benefit to itself. The result should be that even legislators willing to allocate entitlements to the highest bidder will have little opportunity to reverse the initial assignment. Indeed, legislators who subsequently reversed their position might be limited to smaller rewards for their initial decisions, since interest groups would not be able to ensure that their bids would be amortized over a sufficiently long period before the legislation they support is reversed.

Second, the very fact that the first group was able to obtain the benefit may reflect an organizational advantage that it had over the latter group. That same organizational advantage, however, should permit the first group to deflect efforts to strip it of its rewards. Nevertheless, legislators may be more susceptible than courts to revisions and more susceptible to revisions than to reversals. Because proposals for revision (unlike reversals) do not seek to overhaul existing statutory schemes, but only to introduce marginal refinements, they are more likely to privilege particular groups without arousing the ire of competitors. If the benefits available to other groups are not significantly reduced by the proposed redivision of the statutorily conferred "pie," then those other groups will be less likely to oppose proposed refinements. By "refinement," of course, I do not mean to convey anything positive. The very fact that these refinements are likely to be undertaken at the behest of an unopposed interest group suggests that the beneficiaries are obtaining discrete benefits by imposing diffuse costs on others. That recipe often means that the costs of legal change exceed the benefits but that changes are enacted nevertheless for want of organized opposition. Indeed, proposals for revision are perhaps most likely to emerge when a relatively entrenched interest group seeks marginal self-interested adjustments after a period of robust debate has settled fundamental issues that involved potentially competing groups.<sup>9</sup> The incentives that legislatures have to make revisions that benefit these groups may mean there is a bias against legislative conservatism. But it is anticonservatism of an odd sort, both because it involves benefits that may tend to be contrary to social wel-

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9 See Clayton P. Gillette, *Politics and Revision: A Comment on Scott*, 80 VA. L. REV. 1853, 1867-69 (1994). The point is an application of Mancur Olson's general theory that as national economies stabilize, groups that initially faced collective action problems can create selective incentives that facilitate organization. The result is that multiple, but noncompeting, groups each have opportunities to obtain selfish benefits at the expense of social welfare. See MANCUR OLSON, *THE RISE AND DECLINE OF NATIONS* 38-41 (1982).

fare,<sup>10</sup> and because it is most effective with respect to relatively minor adjustments.

In addition, there is another type of conservatism or inertia that is intrinsic in legal rules. Legal rules are themselves often solutions to collective action problems, insofar as they reduce the need for bargaining among agents and minimize the effects of free riding. Even if these solutions can be created through voluntary relationships, especially where some individuals thereby gain disproportionately, these solutions can certainly be facilitated by the presence of a government actor.<sup>11</sup> And if collective action problems are "solved" by the intervention of individuals with idiosyncratic interests, it is by no means clear that the solution will be the one favored by the society at large. The presence of defense manufacturers may be sufficient to ensure that the public good of armaments is supplied, but it may be supplied at a level greater than the public needs.

Once rules are promulgated, however, the same collective action problems reduce incentives to alter rules. As I noted with respect to *stare decisis*, the costs related to effecting legal change discourage efforts at revision unless there exist offsetting benefits that cannot otherwise be obtained. The possible free riding problem is exacerbated if existing rules are imperfect, though "good enough," since the benefits to be gained by participating in efforts to make marginal improvements are smaller than they would be if the public good is not being produced at all. Thus, at least with respect to modifications, legal rules have their own inertial quality.

These systemic tendencies towards conservatism, however, are not my primary concern in this essay. These tendencies are exogenous to the structure of the rule of law at issue and thus apply with equal force to all legal rules. My concern here is with particular forms of legal rules that have unique, or at least nonsystemic, implications for reversibility. My claim is that the design or source of some legal rules entails that different rulemaking institutions will play roles in

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10 The fact that a discrete interest group prefers a particular benefit does not mean that conferral of that benefit is contrary to social welfare. The group may be acting altruistically, or it may be that the private benefits that the group desires can only be obtained if it simultaneously generates benefits to others. Think, for instance, of the successes of environmental groups that may be motivated by the desire of entrepreneurs to obtain fame or to increase federal spending on habitats in which they have an idiosyncratically intense interest, for example, wilderness areas.

11 For discussions of private solutions to collective action problems, see, for example, ANTHONY DE JASAY, *SOCIAL CONTRACT, FREE RIDE* (1989); JEAN HAMPTON, *HOBBS AND THE SOCIAL CONTRACT TRADITION* (1986); MICHAEL TAYLOR, *ANARCHY AND COOPERATION* (1976).



determining whether existing rules will be reversed. If the nature of the legal rule deters those institutions best able to determine that reversal of the extant rule is appropriate, then the inertial effects of the legal rule may exert more conservative force than institutional tendencies standing alone. It is to that possibility that I now turn.

### III. THE PROBABILISTIC NATURE OF RULES AND OPTIMAL PRECISION

The probabilistic relationship between factual predicates and justifications informs the precision with which we draft legal rules. Because rules impose costs on those who must live under them, are costly to draft, and are costly to implement, we typically prefer to regulate only when regulation will produce compensating benefits. Different formulations, however, can be used to regulate the same activity. We can, for instance, deter undesirable levels of pollution by making *ex ante* investigations into emissions levels and safety hazards related to different pollutants and generating a schedule of emissions for a variety of pollutants, or by prohibiting "dangerous" or "unreasonable" levels of emissions with the specific levels to be determined *ex post*, or by some combination. Our resolution of the degree of precision with which to draft rules ideally takes into account all the costs related to their existence: the costs of drafting, of implementing, and of enforcing the rule, including the costs related to restricting the freedom of those who would otherwise act in a manner inconsistent with the regulations.<sup>12</sup> The precision of the rule also has implications for the roles of institutions involved in the process of rule drafting and implementation. A vague standard to drive at a reasonable speed under the circumstances can be legislatively drafted with greater ease than a rule that seeks to define reasonableness under a variety of circumstances, but can only be judicially implemented with difficulty, as fact finders must determine *ex post* what "reasonableness" dictated in the situation before them. Thus, legislative and judicial roles vary with the formulation of the regulation to induce safe driving. The more we believe that a highly tailored rule will fit a broad category of cases (that is, that "one size fits all"), or that drafting with precision was inexpensive, or

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12 On the optimal level of precision, see Ian Ayres, *Preliminary Thoughts on Optimal Tailoring of Contractual Rules*, 3 S. CAL. INTERDISC. L.J. 1 (1993); Colin S. Diver, *The Optimal Precision of Administrative Rules*, 93 YALE L.J. 65 (1983); Isaac Ehrlich & Richard A. Posner, *An Economic Analysis of Legal Rulemaking*, 3 J. LEGAL STUD. 257 (1974); Clayton P. Gillette, *Rules, Standards, and Precautions in Payment Systems*, 82 VA. L. REV. 181 (1996); Gillian K. Hadfield, *Weighing the Value of Vagueness: An Economic Perspective on Precision in the Law*, 82 CAL. L. REV. 541; Louis Kaplow, *Rules Versus Standards: An Economic Analysis*, 42 DUKE L.J. 557, 560, 566 (1992); Carol M. Rose, *Crystals and Mud in Property Law*, 40 STAN. L. REV. 577 (1988).

that agents subject to rules would have difficulty predicting what is expected of them without substantial guidance, the more we might favor legislative statements of precise rules rather than *ex post* judicial applications of relatively vague standards.<sup>13</sup> The more we think that application of the legal standard will require consideration of different factors in different situations, or that the costs of intricate rule drafting could not be amortized over a significant number of cases, or that vague directives give agents a sufficient conception of what constitutes compliance, the more we might prefer judicial application of a relatively nebulous standard. In each case, however, the underlying assumption is that the statement of the rule creates a causal connection between the factual predicate of the rule and its justification with an optimal level of precision. Whether formulated in the final instance by legislators or by courts at the point of application, rules that fail to reflect that nexus with the optimal level of precision will generate costs in excess of the benefits they provide.

Take, for instance, Schauer's example of a rule that emanates from a black Scottish terrier named Angus misbehaving in a restaurant.<sup>14</sup> Schauer suggests if the proprietor of the restaurant were to impose a "No dogs allowed" rule, that rule would satisfy the probabilistic criterion if it were the "dogness" of Angus that led it to misbehave. But if the proprietor mistook Angus's "blackness" or its name "Angus" to be the cause of misbehavior and were subsequently to bar all black things from the restaurant or all things named Angus, we would not have any less of a rule. We would only have a rule that was unlikely to satisfy its objective of precluding the misbehavior that led to the creation of the rule.<sup>15</sup> Because the rule did not emerge from some probabilistic relationship between its factual predicate and its justification, the benefits sought to be generated by the rule (minimizing dog-related annoyances in restaurants) will not be realized (because if, for instance, the rule excludes things that are black, disruptive brown dogs are not excluded), while the costs of the regulation (excluding

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13 On the use of rules versus standards depending on whether *ex post* versus *ex ante* inquiries are more appropriate, see Kaplow, *supra* note 12, at 586-601.

14 See SCHAUER, *supra* note 1, at 25-31.

15 Much of prejudice may work by these forms of misattribution. One who has a bad experience with a person who has a salient characteristic may generalize the cause of that experience to others with that characteristic, even if that characteristic is unrelated to the cause of the bad experience. Assume, for instance, that X is robbed by an African-American who needs money to support a drug habit and who has no legitimate source of funds. Because the robber's African-American characteristic may be more observable than his drug addiction or his economic status, X may generalize that robbers are African-Americans rather than drug users or poor people. See GORDON ALLPORT, *THE NATURE OF PREJUDICE* (1954).

individuals dressed in black clothing) would be greater than is warranted by the underlying justification for the rule.

Thus, the absence of a causal relationship between the factual predicate for the rule and its justification can be viewed in large part as a question of the excess costs generated by the rule as it restricts activity without conferring offsetting benefits. In this sense, the same adverse social result would obtain if the problem were not that the rule was based on a faulty (or "spurious"<sup>16</sup>) factual predicate, but that the rule was formulated at an inappropriate level of precision. Assume, for instance, that a legislature properly identified dogs as the source of the disruption and enacted a legal rule that barred dogs from restaurants. Schauer implies that the rule would still be overinclusive because it excludes all dogs, including seeing-eye dogs that are trained to be well-behaved, and that actually are useful, thereby generating benefits in excess of costs. (The rule would also be underinclusive, since, as Schauer notes, small children and other animals might be equally disruptive.<sup>17</sup> For purposes of making my point here, however, I can focus only on the overinclusive elements of the rule, with the understanding that the same analysis follows with respect to its underinclusive elements.) One might, therefore, wish to adjust the "no dogs allowed" rule, either legislatively in its initial formulation or judicially at the point of application, to permit an exception for seeing-eye dogs.

But it may be that it is difficult for rule appliers (restaurant owners or courts hearing cases of seeing-eye dog owners who were improperly excluded from restaurants) to determine whether the dog in question really was a seeing-eye dog. This difficulty would mean that rule appliers would sometimes admit dogs that were not seeing-eye dogs, in which case the unwanted disruption would occur, and refuse admission to some dogs that were seeing-eye dogs, in which case the dog owner would be denied a benefit unnecessarily. In addition, we would have incurred the decisionmaking costs related to the determination of the status of the dog. If, in fact, these decisions would have to be made with substantial regularity (for example, every dog owner wishing admission to the restaurant would claim that her dog was a seeing-eye dog), we might be better off simply rejecting the exception and implementing the flat rule, even though we know that it would generate results inconsistent with the rule's justification on occasion. Here, the costs and benefits of the flat rule would differ from those

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16 SCHAUER, *supra* note 1, at 27 (stating that only those generalizations causally related to a rule's justification qualify as nonspurious factual predicates for that rule).

17 *Id.* at 28.

that applied with a more precise rule that gave additional discretion to rule applicers; but if the costs of rule application are sufficiently great, then a rule that denies discretion may be the one that is formulated at an optimal level of precision, notwithstanding that it still generates "erroneous" decisions, given the justification for the rule.

The fact that rules are probabilistic rather than particularistic, that they intentionally omit some relevant facts that we would take into account were we to make decisions about what to do in a particular case through a process of comprehensive consideration of all its circumstances, accounts for the necessarily underinclusive and overinclusive nature of rules. While that characteristic may be inherent in what it means to be a rule, it also suggests a limiting feature of rules. For if we formulate rules in order to guide behavior, then in some cases we necessarily incur the costs I referred to above that attend any deviation between the conduct dictated by the rule and its justification. Our willingness, for the sake of minimizing the total costs related to a rule, to eschew rule formulation that tracks justifications as closely as possible means that there will be cases in which the rule is to be applied even though we know that the rule does not fit. Thus, when we seek an optimal level of precision in rules, we are fully aware that those rules will sometimes generate a result different from the one that would have followed from a more particularized inquiry that applied directly the substantive justifications for the rule.

The search for optimality typically requires the articulation of a rule that reflects what we believe will occur in a majority of the situations in which the factual predicate for the rule occurs. At times, however, we may be able to identify a subset of cases in which the factual predicate for the rule exists, but in which there are additional factors that reduce the probability that the justification for the rule will be vindicated by the rule's application. Where these circumstances can be identified, the legislature may create an exception, often identified by a "provided, however" clause that limits the application of the rule. For instance, I have suggested that the "holder in due course" rule, which allows certain transferees of negotiable instruments to take free from claims and defenses that would have been available to the party liable on the instrument if asserted against the transferor, is best understood as a means of placing losses on those parties best positioned to avoid them. On occasion, however, even those who qualify for the privileged status of holder in due course may be better positioned than the party liable on the instrument. If those rare exceptions can be identified by verifiable and unique characteristics that remove the subset from the probabilistic conception that undergirds the rule, then the formulation of a more highly tailored rule, based on a differ-

ent probability, might be superior to a rule that gave all holders in due course the same rights. That desire for optimal precision, therefore, might explain why even a holder in due course takes subject to defenses that the maker is an infant, or incompetent, or acted under duress, since those factual predicates will significantly reduce the probabilistic link to the justification for the general rule (placing losses on parties best able to avoid them).<sup>18</sup>

But it is one thing to be able *ex ante* to identify salient characteristics that make the rule inapplicable to a subset of cases, and quite another to attempt to carve out exceptions at the point of application. That is not to say that courts are incapable of undertaking particularistic analysis at the point of application. Indeed, the overinclusiveness and underinclusiveness of legislatively created rules suggests just the opposite. But if the optimal level of precision takes into account the costs of applying the rule, then there is a limited degree to which the rule can be amended by ad hoc decisionmaking without incurring suboptimal investments in getting the application of the rule "right." From the perspective of institutional design, formulation of the rule as a precise command may signal a legislative intention to preclude further judicial inquiry into the fit between the specified characteristics and the justification for the rule in individual cases, even though all would agree that the result in some cases will be to apply the rule to facts that do not fit the underlying justification. It is in this sense that one can make sense of the claim that "the optimal decision *procedure* may not be the one aimed at producing the best result for each case."<sup>19</sup> Trying to capture the benefits of rules may therefore lead them to be drafted in a manner that assigns courts a relatively inactive role, since once the rule is formulated at an optimal level of precision, judicial inquiry to determine whether an unmentioned exception should apply necessarily alters the optimality calculation.

That the level of judicial inquiry to detect exceptions is fixed by an optimally precise rule might not be problematic were the optimal level of precision static. But the point of optimality is more likely to be dynamic. Recall that the relationship between the factual predi-

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18 See Gillette, *supra* note 12, at 237-43.

19 SCHAUER, *supra* note 1, at 101. Schauer continues:

A decision procedure that aims to optimize in every case may be self-defeating, producing worse results in the aggregate than a decision procedure with more modest ambitions. . . . To put it differently, rule-based decision-making can be seen to be intrinsically and logically conservative (in the nonpolitical sense of that word), abjuring the possibility of complete optimization in an attempt to avoid disaster.

*Id.* at 101-02.

cate for the rule and its justification is what undergirds our presumption that the rule will be appropriately applied in *each* of the cases in which that factual predicate exists, even though we know that there will be misfits. What leads us to apply the rule in the face of that knowledge is our assumption that the exceptional cases are sufficiently rare as to make particularistic inquiry into their existence wasteful.

Obviously, then, our effort to draft the optimal rule means an optimal level of these "erroneous" results. That means not only that we wish to get the initial approximation of the optimal rule correct, but also that we want to be aware of shifts in technology or behavior that might create a new and different level of precision to become optimal. We may learn by application of the rule that the level of precision that we once thought optimal is no longer the case, or never was the case. Technological shifts may, for instance, be warranted by developments in fact-finding that reduce errors in decisions at the point of application.<sup>20</sup> Thus, more accurate means of determining driver's actual speeds may facilitate implementation of a precise speed limit and cause a shift in the optimal level of precision of a safe driving rule. Or the development of DNA evidence may facilitate accurate determinations of guilt or innocence. To return to the holder-in-due-course case, the amount of contracting by children may have increased so dramatically since the formulation of the "infancy" exception that it is no longer the case that subsequent holders can be said to be better positioned than children to detect fraud in the underlying transaction. Alternatively, we may learn about consequences of the rule that were disregarded when it was initially formulated and that make its application more costly than was initially assumed. Recall, for instance, the debacle over the addition of fire retardents to children's pajamas that was discovered to have a greater threat of creating cancer risks than a promise of saving children from burning.<sup>21</sup> Finally, we may come to learn that the rule admits of so many exceptions that the original "optimal" level of precision that once obtained no longer does (or never did) because the number of cases arguably claimed as exceptions is too great.

The problem, of course, is that once courts are informed that the mandate for an optimal level of precision requires them not to make

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20 I believe that this is what Sunstein refers to when he speaks of rules being outrun by changing circumstances, with his examples being the regulation of banking and telecommunications. See Cass R. Sunstein, *Problems with Rules*, 83 CAL. L. REV. 955, 993-94 (1995).

21 See, e.g., Richard A. Merrill, *CPSC Regulation of Cancer Risks in Consumer Products: 1972-1981*, 67 VA. L. REV. 1261, 1323-32 (1981).

particularistic inquiries, they have no avenue for determining that the relationship assumed between the factual predicate and the justification for the rule has changed. Instead, courts that interpret precision as a signal to apply the rule woodenly may ignore opportunities to re-examine the probabilistic assumptions of the rule. The extent to which this effect prevails depends on the source of the shift away from initial relationship between the factual predicate and the justification for the rule. Where the change emerges from some technological advance (whether that advance alters the nature of the prior relationship or demonstrates that the presumed relationship never existed), there may be alternative, nonjudicial mechanisms for reassessing the factual predicate on which the rule is based. Those who discover a new technology can more easily capture its benefits if that technology is accepted, or at least not disfavored by the extant legal rule. Thus, they have incentives to urge the adoption of legal rules that take advantage of their discovery, both in legislative and judicial forums.<sup>22</sup>

But the changes that render the assignments of institutional roles suboptimal may not come from some external discovery, but instead from the strategic reactions to those assignments by the very agents who are subject to the legal rule. That individuals would change their behavior in reaction to a legal rule is, of course, frequently the motivation for implementing the rule. When we enact speed limits, we do so in the hope that individuals who previously exceeded those speeds will no longer do so. Those who are the targets of legal rules, however, may seek to avoid the dictates of a rule by adjusting their behavior in a manner that eludes the letter of the law. For instance, they may purchase radar detectors or speed only when driving in a pack of other speeders or on roads they believe to be infrequently patrolled. Their ability to act strategically depends on the likelihood that their conduct will be detected and sanctioned.

Rather than inducing individuals to circumvent the rule, however, individuals may take advantage of the allocation of institutional roles created by the rule to avoid detection. I have suggested that our epistemic uncertainty about the relationship between the factual predicate of the rule and its justification is frequently resolved by creating a presumption that is based on the rule that we believe would apply in most cases in which we did a particularistic analysis that allowed us to know the "true" state of affairs. Recall that applying a presumption

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22 Of course, this is not always the case, since the technological information may be discovered by those who would not benefit from disclosure of the new information. Think, for instance, of allegations that those involved in the manufacture of asbestos or cigarettes were aware of the hazards of their products.

means that there will be some cases that do not fit the state of affairs assumed by the presumption to exist, but we do not think it is worth our while to make the additional inquiry that is necessary to distinguish those cases in which the presumption is appropriate from those in which it is inappropriate. Once a rule embodies a presumption that forecloses further inquiry into the facts of a specific case, however, parties who might have avoided antisocial conduct out of fear that subsequent particularistic inquiries would lead to detection and sanction will now suffer less disincentive. These behavioral reactions may mean that the rule is "abused," a situation that leads us to allege that someone has violated the spirit, if not the letter of the law.<sup>23</sup> But if the enactment of the rule carries with it the implication that it has been initially articulated at an optimal level of precision, then the consequence that particularistic inquiries into the fitness of the rule in this case are to be avoided reduces the chances that either detection or sanction will occur. For instance, careless drivers may use the stated speed limit as a shield, and drive at a speed that is excessive given the condition of their automobiles (e.g., poor suspension, broken signal lights), but still within the stated limit. The combined result of these abuses should seem familiar given our understanding of moral hazard. An insurer who sets premiums based on an existing number of accidents must consider that the very act of providing insurance may increase risk-taking by insureds and thus increase accident rates above those on which the premiums were initially based. Similarly, the result in our case is that the constraint on courts implemented in the name of an optimal level of inquiry could itself alter the identity of that optimal point. Of course, the possibility that individuals would change their behavior once the optimal rule was announced should itself be reflected in the formulation of the rule. But because the very notion of drafting the rule at an optimal level of precision entails making decisions under conditions of imperfect information about the future effects of the rule, it is possible, perhaps likely, that once the rule is implemented, we discover that our conjecture about those effects was incorrect.

The consequence of defining "optimal precision" under these conditions may be made clearer by examining an example from a current debate in commercial and corporate law concerning the proper scope of judicial intervention to police the behavior of creditors, an

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23 See, e.g., *United States v. Griswold*, 57 F.3d 291, 298 (3d Cir. 1995); *United States v. Castro-Cervantes*, 927 F.2d 1079, 1082 (9th Cir. 1990); *Robbins v. Indiana High Sch. Athletic Ass'n, Inc.*, 941 F. Supp. 786, 793 (S.D. Ind. 1996).



area known as "lender liability."<sup>24</sup> Disputes arise largely when creditors call existing loans or refuse to make further extensions of credit relying on a contractual entitlement to call defaults when they deem themselves "insecure," or otherwise express concern about the borrower's financial stability, notwithstanding the absence of any discrete event that threatens the borrower's venture. One can imagine both malign and benign reasons why a creditor would accelerate a debt pursuant to such a clause. On the malign side, a creditor might be able to take advantage of interest rate shifts since the loan was made if the creditor could now reloan the same funds at a higher rate. Alternatively, the creditor may have animosity towards the borrower for reasons that have nothing to do with the viability of the borrower's business.<sup>25</sup> On the benign side, a borrower may obviously encounter difficulties as a result of factors not described in the loan agreement by a specific event of default, but that nevertheless objectively threaten the prospect that the creditor will receive repayment.

Given that we could imagine either malign and benign explanations for loan accelerations pursuant to the clause, we could either formulate a presumption about the motivation of a creditor based on what we believe is the conduct of creditors generally, or we could enable courts to make a particularistic inquiry about the motivations of the creditor in each case. Those who contend that ad hoc inquiry is appropriate point to the presence of an obligation of "good faith" under which creditors operate as the doctrinal basis for judicial investigation.<sup>26</sup> My analysis to this point suggests that whether we believe that courts should use general principles of commercial law, such as an obligation to act in "good faith," to police creditor misconduct depends on whether we believe that the costs of judicial intervention exceed the benefits of such a vague rule, administered in a particularistic manner. Assume, for instance, that creditors on balance exercise

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24 See, e.g., Daniel R. Fischel, *The Economics of Lender Liability*, 99 YALE L.J. 131 (1989); Clayton P. Gillette, *Commercial Relationships and the Selection of Default Rules for Remote Risks*, 19 J. LEGAL STUD. 535, 565-74 (1990); Dennis M. Patterson, *A Fable from the Seventh Circuit: Frank Easterbrook on Good Faith*, 76 IOWA L. REV. 503 (1991).

25 This seems to be the nature of the allegation in a well-known case of lender liability, *K.M.C. Co. v. Irving Trust Co.*, 757 F.2d 752, 761 (6th Cir. 1985). In that case, the court determined that the bank had refused to make further advances under a line of credit arrangement because of a personality conflict between the lender and borrower. But the court also noted that this conflict arose out of a bank officer's disapproval of K.M.C.'s management philosophy. If the nature of the personality conflict truly evolved from concerns about the manner in which the borrower was operating its business, the lender is less susceptible to the claim that personal animus, rather than financial considerations, motivated the refusal to approve additional advances.

26 See, e.g., Patterson, *supra* note 24.

good faith on those occasions in which they deem themselves "insecure." This is a plausible scenario, since we can imagine reasons why both creditors and borrowers would prefer to have such a clause in a loan agreement. The borrower might treat such a clause as a signal of its willingness to have the lender monitor the borrower's business and its confidence in the success of the enterprise being financed with the loan proceeds; the creditor might consider such a clause to be necessary in light of the difficulty of enumerating all possible events that give rise to insecurity about the borrower's business. For instance, the lender may be concerned that the borrower will use the creditor's money to pursue a business plan substantially more risky than the one that the borrower proposed at the time that the loan was procured.<sup>27</sup>

Under these circumstances, the role we are willing to assign courts to police a creditor's use of a "deems itself insecure" clause may depend on whether we believe that, on balance, the malign or the benign story accounts for the cases that appear before courts. To the extent that we believe that creditors typically accelerate payment only when they have good reason to do so, but that disgruntled borrowers (or their surrogates, such as trustees in bankruptcy after the borrower's business has met its demise in alleged reaction to the creditor's inappropriate suspension of credit) still bring suits against creditors in the hope that they can shift to creditors responsibility for the business failure, we may want to reduce judicial involvement in the credit termination decision. Of course our willingness to reduce judicial involvement does not mean that creditors never misbehave; it means only that we believe that creditors will *tend* not to misbehave and that the likelihood of misbehavior in any particular case is sufficiently small as to foreclose investigation of lender misbehavior in all cases. Our willingness to accept what we consider to be only occasional errors in granting effective immunity to misbehaving creditors is enhanced by our concern that particularistic judicial application of a vague standard (as in the case of the "seeing-eye dog" exception) will generate errors that more than offset the gains of ad hoc decision making. Courts and juries, sympathetic to failed businesses, may find misbehavior where none existed, and are also likely to leave some cases of actual misbehavior undetected, so that some costs of judicial investigation will be wasted.

Thus, an optimally precise rule for lender liability might deny courts the ability to undertake intensive monitoring of creditors who

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<sup>27</sup> See Robert E. Scott, *A Relational Theory of Secured Financing*, 86 COLUM. L. REV. 901 (1986).

use "insecurity" clauses to terminate credit, notwithstanding that some creditors will thereby avoid liability for bad faith terminations. The result depends on beliefs that (1) as a probabilistic matter, creditors are unlikely to terminate credit in bad faith, that is, there exist sufficient extrajudicial checks on strategic behavior by creditors that the marginal benefits generated by judicial policing are small; (2) there is no subset of cases in which courts making more particularistic inquiries can readily verify some salient characteristic (as in the infancy, incompetency, or duress holder in due course cases) as a surrogate for bad faith terminations; and (3) courts applying a general "good faith" standard to make particularistic inquiries will make frequent errors that generate both false positives (imposing liability on lenders who terminated credit facilities in good faith), and false negatives (finding no liability on lenders who terminated in bad faith). That judicial errors will be frequent seems inevitable, given that courts are essentially attempting the difficult task of discerning the bank's motivations for terminating credit. The existence of extrajudicial checks also seems likely, given that financiers operate in relatively competitive markets, so that a reputation for prematurely terminating credit facilities would likely cost the malefactor profitable business. Given that judicial intervention will be costly and (correctly applied) would not likely discover substantial lender misbehavior, we might expect to see the development of a legal rule that gave courts limited authority to intervene in termination decisions.<sup>28</sup>

One might object that courts could at least intervene to determine whether there is some reason to believe that further inquiry would reveal misbehavior. I take it that this is the nature of the claim in Schauer's advocacy of what he calls "presumptive positivism." That claim is directed at the force of a rule designed to govern a set of cases rather than to the probability that it would be found to be appropriate for application after particularistic consideration of one of the cases within the set.<sup>29</sup> But the effect is much the same when applied to the search for an optimally designed rule predicated on probability. The purported effect of presumptive positivism is that courts will apply the favored, though incompletely considered rule unless "the reasons for overriding are perceived by the decisionmaker to be particularly strong."<sup>30</sup> Schauer perceives but rejects one problem with such an

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28 See, e.g., *Kham & Nate's Shoes No. 2, Inc. v. First Bank* 908 F.2d 1351 (7th Cir. 1990).

29 See SCHAUER, *supra* note 1, at 203.

30 *Id.* at 204. The possibility that application of the rule would produce an erroneous or suboptimal result in the particular case before the court would not constitute a strong reason for overriding its application. *Id.*

analysis, that is, that courts will have to consider "rebutting considerations" in *every* case subject to the presumptive rule in order to determine whether the presumption should be rebutted, but then will be unable to ignore those factors in cases initially considered to be insufficiently egregious to avoid the presumptive rule. Schauer believes instead that "decisionmakers can tell the difference between a factor that would control were the decision process particularized and a factor that does not control because of the presumption or burden of persuasion that prevails in a particular decisional environment."<sup>31</sup>

I have little difficulty with that argument. But if the same logic applies to the cost-saving feature of the presumption, the presumptive nature of the rule poses an additional difficulty. As Sunstein suggests, "the mere possibility of an exception or an excuse in all or almost all cases involving rules . . . means that there is a possibility of an exception or an excuse everywhere, or almost everywhere."<sup>32</sup> Admitting that the "rebutting considerations" must be investigated in every case means that much of the savings that the presumption purported to create is ultimately lost as each party adversely affected by the presumption has both the incentive and the opportunity to invite the court to rebut it. The result is that a more wooden, or irrebuttable form of presumption may be necessary if the rule is to capture the benefits that it purports to create. It may be that we minimize costs when we simply recognize that there will be some cases in which application of the presumption leads to the "wrong" result, but do nothing to rectify the situation.

But this realization gives rise to an additional difficulty, if our concern is to ensure a relationship between the factual predicate for a rule and its underlying justification. Once we announce that the optimal form of the rule precludes courts from making particularistic inquiries, creditors who might otherwise have avoided strategic terminations may now engage in them with impunity. Creditors who might not have taken advantage of increased interest rates or acted against debtors out of personal spite for fear of judicial correctives may now feel more freedom to act in a self-interested manner without judicial detection. The result is that the mix of malign and benign terminations could change sufficiently to warrant a different rule if we were aware of the new proportions. The very fact that courts are not involved in the process of detecting strategic terminations, however, means that we will not easily become aware of the frequency of creditor stratagems. The rule that assigns a limited role to courts thus con-

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31 *Id.* at 205.

32 See Sunstein, *supra* note 20, at 987.

tains the basis for the perpetuation of the existing substantive rule. The very act of foreclosing judicial inquiry thwarts the evidence necessary to permit reversal or revision.

The result is that certain rules, once entrenched, become subject to a form of irreversibility. They are based on certain empirical assumptions that may be true at the time of the rule's promulgation. But the existence of the rule simultaneously induces actors to change their behavior in ways that contradict the presumptive behavior that underlies the rule, and retards subsequent re-examination of the rule to see if its empirical foundations remain intact. The quest for an optimally precise formulation of the rule, therefore, is frustrated by the dynamism of reactions to the rule once it has been articulated.

#### IV. RULES TO SECURE COOPERATION

My discussion to this point suggests that the conservative or inertial effects of a rule will be greatest if the rule is designed in a manner that precludes a potential rulemaker (usually the judiciary, but theoretically the legislature as well<sup>33</sup>) from revisiting its empirical foundations. The argument to this point has involved rules that are based on probabilities of a specific sort. Those rules were promulgated in the belief that their factual predicates were causally related to their justifications. Thus, in any case in which the factual predicate occurred, it could be presumed that application of the rule would forestall the harm to be avoided or confer the benefit to be obtained by the rule. In this sense, they are what I call "majoritarian rules," because they reflect a presumption about what will occur a majority of the time that their factual predicates occur. At the same time, the fact that those consequences follow a majority of the time, but not every time that the factual predicate occurs, and that the consequences to be regulated can occur even without the existence of the factual predicate, is what gives rise to the possibility that behaviors may shift, causing the majoritarian presumption to fail.

But not all rules have their origins in efforts to instantiate a presumption of what consequences follow a majority of the time that their factual predicates appear. Rather, some rules may be formu-

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33 Legislatures are typically allowed to override the acts of their predecessors and to initiate the inquiries necessary to reverse existing rules. But some legislation requires supermajority votes, which reduces the likelihood of reversals or revisions of existing rules on the same subject. Constitutional provisions, of course, also limit the scope of reversal. But these requirements usually reflect that something other than a purely majoritarian rule, based on what most people prefer under a given set of conditions, is at stake, and are thus perhaps better subsumed under the subsequent discussion of varying conceptions of costs associated with rules.

lated simply to create a practice to which agents are expected to conform because conformity will generate greater value for all concerned, including those agents who conform to the rule. Even nonaltruistic individual agents desire to behave in a socially rational manner in these situations, because doing so also serves self-interest. It is the existence of a signal of how to conform, or to cooperate, rather than any predictions about what will follow from the rule's factual predicates, that provides the value of the rule. Thus, the rule is probabilistic in the sense that, once announced, agents who find themselves in situations characterized by the factual predicates for the rule will be likely to follow the dictates of the rule, since the agents seek to cooperate, as long as all other similarly situated agents also cooperate. This is obviously a different notion of a probabilistic relationship than the previously discussed concept that assumes a connection between factual predicates and justification for the rule. Nevertheless, the fact that agents will coordinate in the manner dictated by the rule indicates that the factual predicate for the rule is linked to its justification, that is, to generate cooperation.

#### A. *Signals of Coordination*

Rules that signal coordination points may be useful in either of two situations. In some situations, all parties have a common objective of cooperation, but cannot easily communicate about what the agreed point of cooperation should be. The announcement of a rule simply reflects their preferences to have a common signal of cooperative action. We may be indifferent as to the content of the rule (at least as among multiple possibilities), but not indifferent as to its existence, because the rule allows coordination of activity the value of which would be greatly reduced if coordination could not occur. We might, in the classic example, be indifferent as to whether people drove on the right or left side of the road, at least prior to the manufacture of automobiles with steering wheels on one side of automobile or the other, but not indifferent as to everyone driving on the same side of the road as everyone else. The choice between the two possible rules, however, has nothing to do with probabilistic relationships between factual predicates and justifications (although each of the candidates may be based on probabilistic reasoning).

The second situation involves situations of potential conflict because agents, acting strategically, would otherwise pursue strategies that are individually rational, but socially irrational. These activities typically take the form of prisoner's dilemmas or chicken games, in which each agent's concern about what other agents might do leads

all the relevant agents to behave, self-interestedly, in a manner that deprives them of gains that would be available if they cooperated. Legal rules avoid these losses by providing information about the first-best solution and creating an enforceable obligation for each agent to cooperate.

In each case in which cooperation is desired, a rule that induces that cooperation simultaneously frustrates reversibility if, subsequently, a preferable point of cooperation is discovered. This is alluded to by Schauer when he notes in his discussion of rules that solve coordination problems that the primacy of that objective means that agents, who do not want to deviate from what others do, "will tend towards the entrenchment of general rules even in the face of inclinations to modify them at the moment of application."<sup>34</sup>

Here I think that Schauer's account of the evolution and stability of the rule is quite correct; but its implications are more problematic and robust than his account suggests. Recall that the rule to solve the coordination problem is not selected to reflect a probabilistic view of the true state of affairs, other than to suggest that there are multiple equilibria that could be selected and one prominent solution may be particularly salient to those subject to the rule.<sup>35</sup> But once we create a solution to the coordination problem, that solution becomes entrenched in ways that, again, impede its reversibility, notwithstanding that the conditions that led to its initial selection have changed. In Schauer's account of the process, that entrenchment is the consequence of deference to community. Individuals living under rules developed to solve coordination problems may confront situations in which modifications of a rule seem superior to its wooden application. Nevertheless, if those individuals fear that subsequent actors who face the same situation will fail to make the modification that seems desirable, the first set of individuals will, in the name of preserving cooperation, "resist the urge to make a seemingly desirable modification."<sup>36</sup> Thus, the statement of the rule remains quite general, even though the optimal level of precision might properly require a more highly tailored statement of the rule and exceptions to it. The very collective

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34 SCHAUER, *supra* note 1, at 165.

35 THOMAS C. SCHELLING, *THE STRATEGY OF CONFLICT* 57-58 (1960).

36 SCHAUER, *supra* note 1, at 165. Schauer continues:

The ability of the rules of language or the rules of the road to work, therefore, may be largely a result of the willingness of co-operatively inclined participants in the rule-system to resist urges to make the rules better, for they can be less sure that other agents will make the same modification than that other agents now employ the unmodified rule.

action problem that the rule was promulgated to solve stands as an obstacle to its revision.

Again, I have no difficulty with this account as far as it goes. The problem is that it understates the difficulty of reversing (or revising) the rule initially laid down beyond the inertial concerns that affect all legal rules. Assume that we all agree that a coordination solution initially settled on is socially suboptimal at the current time (even though it may have been correct at the time of its initial promulgation). For instance, a country that initially decided that drivers should drive on the left might come to realize that most countries drive on the right and that most motor vehicles are designed for driving on the right. As a result, citizens in the country that follows the minority rule have less access to motor vehicles than do citizens of other countries. This is not to say that the initial decision was "wrong." To the contrary, it was a perfectly appropriate decision under the conditions of uncertainty in which it was made (there being no prominent solution at the time of decision). It is only to say that the decision becomes costly in light of subsequent events. We can imagine, for instance, that at the time when the decision was made, the decision matrix for any given driver (A) and all other drivers (B) for driving on either the left or the right side of the road looked something like the following:

		B	
		Left	Right
A	Left	1, 1	-1, -1
	Right	-1, -1	1, 1

In short, the original situation was one in which there were two coordination equilibria, the lower-right and upper-left cells, but we would have been indifferent between them. But the passage of time may alter the situation, so that we are no longer indifferent, because the decision matrix now looks like the following:

		B	
		Left	Right
A	Left	1, 1	-1, -1
	Right	-1, -1	2, 2

It would be better if all persons drove on the right, even though things are better with everyone driving on the left than if some drove on each side. Thus, for the reasons that Schauer illustrates, drivers on the left have no reason to reverse the rule. While conventional plays



are typically seen as solutions to collective action problems,<sup>37</sup> the articulation of the solution through promulgation of a rule may also frustrate efforts to reverse the rule when conditions would warrant it. It is in the nature of the coordination equilibrium that parties will “stick” to their positions, because no one person can improve matters by himself or herself through unilateral movement. The preferred position is, therefore, individually inaccessible.

It is tempting to say at this point that legislative solutions should be available to solve the problem of inertia. After all, the legislature can simply mandate the new coordination equilibrium; since all would agree on the improvement, the standard interest group concerns will not arise. Thus, the parties need not cooperate. All that is necessary is that one party apprise the centralized decisionmaker of the new solution. Once that is accomplished, the decisionmaker should be able to impose the new equilibrium on all parties, all of whom will be satisfied with the change.

Features of cooperation games, however, may exacerbate collective action problems at the legislative level. The very fact that all parties will benefit from the change means that free riding problems are likely to be greater in this situation. Given that the steps taken to effect the underlying change—assembling the information, informing the legislature—are costly, anyone who incurs these costs decreases the net benefit from these changes, and would not suffer that fate if some other party undertook the same task. Given that all would benefit from the change, the opportunities for free riding are greater than in the case in which a discrete group would enjoy idiosyncratic benefits from the changed rule. Further, the transaction costs involved in shifting from the existing coordination point to the “superior” one may eliminate all the gains, so that the current rule is efficient, even if it would not have been selected initially if we had known at that time all that we know now.

It may be, of course, that the benefits of the rule are not uniformly distributed. Traffic sign manufacturers, for instance, may benefit disproportionately from the change and thus be willing to lead the charge. But if the “improvement” produces unequal benefits throughout the society, the resulting bargain about the division of benefits may frustrate efforts to reverse the rule. Assume, for instance, that the proposed change would alter the payoffs in the lower right cell from 1, 1 to 1, 2. There is still reason to change from the upper left to the lower right cell, but now A has nothing to gain from the change and may attempt to hold up B for some share of B’s gain.

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37 See RUSSELL HARDIN, *COLLECTIVE ACTION* 156–61 (1982).

Alternatively, if the payoffs in the lower right cell change from 1, 1 to 2, 3, A again has incentives to hold out in order to induce B to share some of the greater surplus that B realizes from the change.

These inequalities are likely to be endemic in coordination problems because the initial assignment of entitlements, even though it arose from relatively benign circumstances, is likely to privilege a particular set of persons who are likely to oppose any alteration of the existing rule. Having invested in a system of driving on the left, a discrete group of interests (including domestic motor vehicle producers who must retool their products and then face competition from increased imports), are likely to oppose any such shift. The problem of preserving overly generalized coordination rules, that is, does not arise so much from the community-preserving element of coordination solutions, but from its opposite, the entreaties of groups with an intense interest in maintaining the status quo, notwithstanding that the conditions that gave rise to that status quo have changed. But the presence of groups with intense interests in the status quo is simply an example of the systemic biases against reversibility that I earlier suggested were outside my major concern here. And if there is a sufficient interest group that would benefit from the change (potential automobile importers and foreign exporters), then they may coalesce in a manner that facilitates legislative adoption of the new rule. Thus, the possibility of legislative solutions falls outside my claim that the nature of the rule adds a dimension to the problem of reversibility.

Similarly, one might contend that the problem here is simply one of information.<sup>38</sup> All parties might move to the lower right cell if they knew the payoffs in that cell, since all parties will be better off in that cell. Thus, as long as we publicize the relevant information, reversibility should occur. The problem with this solution is that it will not be enough that all parties have the relevant information. Even if I know the payoffs in the lower right cell, I will not move unless I believe that you know what I know and are willing to act on that information. And you will only act on the information if you know that I have the relevant information and you know that I know you have the relevant information. In short, all parties must know that all other parties have the information, and that all parties know that all other parties know they have the information. The knowledge requirement need not regress too much in order to realize that it poses significant difficulties in a multiparty universe. Thus, some sort of legal regime may be necessary not simply to solve the coordination problem, but to alter a solution on which there has been prior agreement.

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38 I am grateful to Steve Walt for discussion on this point.

### B. *Coordination and Majoritarian Defaults*

These points may be made clearer by comparing rules that identify an arbitrary coordination point with those rules that are intended only to replicate the specific preferences of parties engaged in the activity that the rule addresses. Here, the rule at issue again has its source in some objective other than inhibiting one agent from inflicting harm on another. Instead, the function is to codify a practice that parties subject to that practice would presumably follow anyway. By embodying the practice within a legal rule, the parties avoid any residual uncertainty about their obligations or the costs of negotiating about the scope of those obligations. This is frequently characteristic of the rules of contract, and sometimes of the rules of tort. Here, I think that reversibility is less of a problem, but largely for the reason that makes the argument in the lender liability case more apparent.

Contract rules typically take the form of default rules, around which parties are free to contract, but that apply in the face of contractual silence. These rules tend to be drafted in a manner that simply reflects the rule that we believe would be preferred by most parties whose activity is subject to the rule. At the same time, transforming that rule into a default for those who enter into bargains offers the advantage of reducing transactions costs, because only those parties so idiosyncratic as to want to opt out of the default rule will have to bargain about the contractual term at all.<sup>39</sup> For instance, rules concerning the risk of loss for goods sold tend to place the risk on the party who has control and dominion over the goods, regardless of passage of title, on the understanding that any such party can more cheaply protect the goods against loss, and thus would be the party to whom most contract parties would assign the risk. There is an additional assumption that underlies this rule, however. Implicitly, we believe that the parties to the contract internalize virtually all the costs related to the choices they make. That is, they serve as surrogates for third parties, such as their customers and employees, so that no external effects go unconsidered in their decision to create a bargain, since they would ultimately bear the costs of all these effects. For instance, a contract that imposed excess costs on customers would cause sellers to lose business to competitors. Hence, there is little reason to believe

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39 This defense of majoritarian principles overstates the case for majoritarian defaults a bit. It might be the case that a party would actually prefer an alternative to the default rule, but the expected costs of accepting the default rule are less than the costs of contracting around it. In such a case, the party would actually prefer a *different* default rule, thus he or she cannot be said to have preferences that coincide with the existing default rule.

that the bargain these parties would reach differs materially from the calculus that would be struck from a social perspective, since the parties serve as appropriate proxies for the society at large.<sup>40</sup> Thus, drafting the legal rule in terms of preferences of a majority of those who contract under conditions subject to the rule will not vary from a fuller assessment of the social costs and social benefits that the rule would generate.

As in the case of the rules with which we began, there is a probabilistic relationship between the factual predicate for default rules and their justification. The fact that a purchaser obtains possession of goods means that the purchaser is the better bearer of the risk of loss, even though title has not passed. Hence, a legal rule that places the risk of loss on the purchaser in this situation satisfies the probabilistic relationship that we prefer. And like our prior situations, there will be cases in which the probabilistically generated rule does not hold true. Sometimes, sellers may be better able to insure even though they do not have dominion and control over the goods, or a purchaser who places an idiosyncratically high value on a good may want to bear the risk of loss even though she does not yet have possession of it, because she wants to require the possessor to take certain precautions against loss. But unlike our prior situations, the bargain element of the situation suggests that strategic behavior is less likely to occur. If the rule is articulated to reflect the preferences of the majority of parties who enter into such transactions, and if the parties are able to capture the benefits (reduced transactions costs) of such a rule, then they have every incentive to discover and disclose any change in the relationship between the factual predicates that undergird the rule and its justification. Where rules reflect majoritarian defaults, the parties whose preferences are reflected in those defaults have both the incentives and the opportunity to internalize the costs of the rule and to reduce the error involved in making allocations. They, even more than legislators, have every incentive to formulate a rule at the optimal level of precision, since they personally bear the costs of imprecision. They therefore similarly have incentives to discover and reverse rules that no longer serve their intended function of signaling what most similarly situated agents would prefer. Given the low likelihood that the parties would deviate from an optimal rule at any given time, rules that arise from majoritarian defaults are less likely than other rules to suffer from irreversibility.

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40 There are obviously circumstances in which this assumption does not hold true. For instance, parties may contract for price fixing arrangements that impose substantial costs on others that are not internalized by the parties to the bargain.

## V. EXPECTED COST CALCULATIONS AND REVERSIBILITY

To this point, my concern about the reversibility of legal rules has focused on the capacity of an institution charged with applying the rule to determine whether the factual predicate for the rule remains linked to its justification with sufficient probability as to warrant continued use of the rule. Thus, the "no dogs allowed" rule presumes that, in a substantial majority of cases in which dogs are allowed into restaurants, they will impose costs on patrons in excess of the benefits that would be conferred on dog owners if they were allowed free access with their pets. Indeed, it is because the link between the factual predicate for the rule (disruptive dogs) and the harm to be avoided or benefit to be conferred is so close that we might initially believe that rules are readily reversible because any severance between the two will be easily observed.

Legal rules, however, do not necessarily represent a purely probabilistic relationship between factual predicates and justifications for the rules. Instead, some rules, far from being linked to probabilities, may be in direct conflict with the conditions that we believe exist in the majority of cases where the factual predicate for the rule is found. We might think of legal rules of this sort as "nonmajoritarian" presumptions or rules. Think, for example, of the presumption that a criminal defendant is innocent and that thus places on the government the obligation to demonstrate guilt. I doubt that many of us would contend that the presumption of innocence is rooted in a belief that most persons put on trial are, in fact, innocent. The rationale for the presumption in such a case has less to do with probabilities standing alone than with the use of the probability to discount the harm that would occur were we to employ the opposite presumption. Our concern in these cases is, therefore, not with what will occur in the majority of cases to which the rule applies, but with the expected losses that will materialize in those cases in which application of the presumption leads to the "wrong" result.

Recall that we understand that there will be some cases in which a majoritarian rule will not fit, but we apply it without trying to detect the identity of those cases because the costs of a more particularistic inquiry (that is, the costs of false positives) are not worth incurring.<sup>41</sup> Although the rationale for wooden application of the rule typically seems to be stated in terms of the low probability that the exceptional case will arise, the existence of nonmajoritarian presumptions suggests that a more complicated analysis really underlies the application

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41 See *supra* text accompanying notes 16-19.

of presumptions generally. In addition to our belief that there is only a remote probability that any given case would not warrant application of the presumption, our application of the majoritarian presumption also implicitly assumes that the costs related to any given instance of "wrongful" application of the presumption are not very high. For example, when we presume that a creditor will terminate loans only in good faith, even though we know that some creditors will act in bad faith, we are implicitly deciding that the social costs related to immunizing the occasional bad actor, discounted by the probability that any actor falls within that category, are insufficient to warrant further investigation.

This type of reasoning is familiar from economic explanations of negligence law.<sup>42</sup> There, for instance, one does not assign liability based solely on a high probability that an accident will occur if precautions are not taken. Rather, that probability is used to discount the accident costs that society incurs if the accident does materialize. We would, for instance, not impose negligence liability on a party who failed to take precautions against bumping individuals on the subway, notwithstanding the high incidence of such events, because the harm caused by such bumping is sufficiently slight that the expected loss (harm from bumping discounted by its probability) from allowing the accident is too small to warrant the precaution costs that would be required to avoid the loss.

Of course, this "Learned Hand" test of negligence liability<sup>43</sup> works to impose liability as well as to immunize against it. Failure to protect against harms that threaten substantial losses will be considered negligent, even though the probability of their materialization is quite low. Even expensive precautions will be justified to protect against accidents in nuclear power plants, notwithstanding their low probability, because the consequences that will materialize should the low probability event materialize is so great. And that is just the point that obtains with respect to legal rules that are framed in terms of a nonmajoritarian presumption. Such rules reveal that the costs related to applying a majoritarian rule in the numerically few cases in which it does not fit are so significant as to warrant the use of an alternative rule for all cases. For instance, even if we believe that most criminal defendants are guilty, thus justifying a majoritarian rule that presumes

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42 See Richard A. Posner, *A Theory of Negligence*, 1 J. LEGAL STUD. 29 (1972).

43 The "Learned Hand" test of negligence, in which accident precaution costs are compared to accident losses that would occur in the absence of precaution discounted by their probability, is attributed to Judge Hand's opinion in *United States v. Carroll Towing Co.*, 159 F.2d 169 (2d Cir. 1947).

guilt, the social costs of convicting the few innocent defendants are considered so great that the expected loss that results from application of such a presumption (costs of convicting the innocent discounted by its probability) render the majoritarian presumption inappropriate. That is the case even though application of the nonmajoritarian presumption of innocence generates its own set of costs, that is, acquittal of some number of guilty defendants. Our use of the nonmajoritarian presumption implies that those costs are significantly outweighed by the costs related to conviction of the innocent.<sup>44</sup>

That we typically form presumptions related to expected losses, rather than to naked probabilities, seems to me to be uncontroversial. Take, for example, the common rule that requires a public school to evacuate all students when a fire alarm rings. If presumptions followed from majoritarian perspectives alone, one might infer that this rule is based on a belief that when a fire alarm rings, there is, more probably than not, a fire in the building. But no one who has spent significant time in a public school believes that there is an actual fire on the majority of occasions in which alarms are sounded. Thus, a purely majoritarian view would restate the rule to say that evacuations should not be ordered when a fire alarm rings, unless there is independent confirmation of a fire. Nevertheless, the costs associated with an occasional false negative may so exceed the costs associated with a false positive of a fire, that we are willing to accept a rule that is inconsistent with our epistemic beliefs about the state of affairs in the situations to which the rule applies. On a more mundane level, think of defaults created in computer programs. If I select a file for deletion from my hard drive, the computer asks me if I really want to delete the file and the computer program makes the default answer to that question "No." Typically, if I have gone through the steps necessary to delete a file, I will have desired that it be deleted, although occasionally I will have mistakenly chosen a file for deletion. Thus, a majoritarian default would likely be an affirmative answer to the question of whether I want to delete the selected file. Nevertheless, the cost of mistakenly deleting a file may be so substantial that, notwithstanding its infrequency, the expected costs of that action exceed the costs related to the extra step necessary to overcome the default command that cancels the deletion. Or think of more exotic examples,

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44 Frederick Schauer's recent work on adverse decisions adopts an assumption that the cost of wrongful conviction is approximately 20 times as costly as the wrongful acquittal. See Frederick Schauer & Richard Zeckhauser, *On the Degree of Confidence for Adverse Decisions*, 25 J. LEGAL STUD. 27, 34 n.11 (1996).

such as our decisions to avoid risks in the environmental area that have a low probability of occurring, but that threaten incalculable harm should they materialize.<sup>45</sup> These risks have been labeled "zero-infinity" risks insofar as they are highly unlikely (approaching a zero chance of occurrence) to materialize, but will cause infinite harm should that remote event come to pass. Again, low probability alone does not dictate our action, but is instead factored into an expected loss calculation to determine an appropriate presumption or default rule.

My concern however is not simply with demonstrating the common phenomenon that presumptions emerge from expected loss calculations rather than from probabilities alone. Rather, my concern again lies with the implications of that phenomenon for reversibility of a rule promulgated in accordance with an expected loss calculus when the factual assumptions underlying the rule turn out to be erroneous or to have changed. Here, again, the limited competence of certain decisionmaking institutions frustrates efforts to determine the continuing relationship between factual predicates for the rule and their justification. The limited competence of both legislatures and courts, for instance, is severely tested by nonmajoritarian presumptions. An initial difficulty arises simply because an additional calculation (expected loss) is necessary. The decisionmaker must do more than simply calculate the probability with which the existence of the factual predicate for a rule generates a particular result, and that additional calculation requires data (losses per incident) that may not be readily accessible.

The computational problem is exacerbated, however, by the very nature of the losses that are typically at stake in cases where expected losses are high, notwithstanding low probabilities. Far more than the head-counting or rough approximation of frequency that the calculation of probability alone requires, the factors that make expected costs high in these circumstances tend to be relatively unsusceptible to quantification. Nonmajoritarian rules tend to focus on avoiding salient harms, such as the elimination of a particular species, the potential death of particular school children, or the imprisonment of a particular individual. These harms tend to entail just the kinds of costs that defy measurement, for two reasons. First, these harms tend to bear just the opposite characteristics of majoritarian default rules in contract. Recall that in those cases, our sense was that the parties in-

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45 See, e.g., Talbot Page, *A Generic View of Toxic Chemicals and Similar Risks*, 7 *ECOLOGICAL L.Q.* 207 (1978); Christopher H. Schroeder, *Rights Against Risks*, 86 *COLUM. L. REV.* 495 (1986).



ternalized essentially all the costs and benefits of the legal rule, and thus they would have sufficient incentive to contend for a legal rule that reflected the socially desirable default. For that reason, I suggested reversibility would be facilitated in an appropriate case because parties affected by an obsolete rule would have sufficient incentives to alter it. In many of the cases of nonmajoritarian defaults, however, the relevant costs tend to be diffuse throughout the population (for example, the demoralization costs related to the fear that innocents could be arrested and required to bear the burden of disproving guilt). Hence, there is less reason to believe that the rules that particular parties advocate will reflect socially desirable rules, since those parties do not internalize the full set of costs and benefits that attend the rule. Any quantification of harms at the point of application is, therefore, likely to be incomplete.

Second, the nature of the harms that nonmajoritarian rules seek to avoid tend to be less tangible, and hence less quantifiable, than the harms that are at stake in judicially accessible calculations. The very fact that avoiding an event of low probability still has a significant expected value suggests that the loss will be critical should the event materialize. But we often attribute that result to a rule because we cannot easily quantify the relevant harm in a manner that allows it to be compared with the cost of avoidance. We attribute high expected costs to these harms because we have particular aversion to the risks that generate such harms, rather than because these harms destroy goods or services with a discrete market value that is readily measured. Think, for instance, of the difficulty we suffer in attempting to value identifiable lives versus statistical lives, and that thus generates default rules (such as the fire alarm rule) that require avoiding certain harms, regardless of their low frequency.<sup>46</sup> Or think, more specifically, of the Delaney Clause, which bars the use in food of any additive that is carcinogenic, regardless of the probability that it will induce cancer.<sup>47</sup> In these areas, we tend to speak of "values," "soft variables," or "incommensurables" rather than in terms of quantifiable and verifiable statistical analyses based on widely accepted computations. Such values or variables, however, are hardly susceptible to judicial analysis or revision at the point of application or even to legislative reformulation. Our attitudes towards particular risks might change, but it is difficult

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46 The classic treatment is found in Thomas C. Schelling, *The Life You Save May Be Your Own*, in CHOICE AND CONSEQUENCE 113, 115-19 (Thomas C. Schelling ed., 1984). See also Charles Fried, *The Value of Life*, 82 HARV. L. REV. 1415 (1969); E.J. Mishan, *Evaluation of Life and Limb: A Theoretical Approach*, 79 J. POL. ECON. 687, 693 (1971).

47 21 U.S.C.A. § 348(c)(3) (West 1972).

to imagine how courts or legislatures would revisit precise rules drafted in light of past attitudes to reverse those rules in light of new attitudes. Since the expected losses on which rules were originally based are not susceptible to easy mathematical calculation, it is more difficult to detect that the factual predicates on which those rules were based have become unmoored from their justifications. Thus, for example, legislators have been unwilling to eliminate the Delaney Clause to accommodate substances with only minute carcinogenic properties, even as our understanding of risk assessment has led to greater acceptance of certain environmental risks. In addition, legislators fail to revise rules that permit marketing of existing substances that create risks that might be found unacceptable in new substances.<sup>48</sup> The result is that, once formulated, nonmajoritarian rules that rely on such factors become essentially irreversible because of empirical difficulties involved in demonstrating that the assumptions on which they were initially based no longer apply or fail to apply in an individual case.

There is, of course, nothing inherently problematic about nonmajoritarian rules. Our inability to quantify factors that are relevant to the formulation of a rule does not render the rule illegitimate or inappropriate. At the same time, we should be aware that such principles contain inertial effects that are likely to keep them entrenched once formulated. Perhaps our response should be to exercise care in the way we formulate such rules. Legal rules cast in terms of "reasonableness" permit changes in risk attitudes to be incorporated at the point of application in ways that flat rules do not. A particular substance, for instance, might today be seen as presenting an unreasonable risk, although that risk may subsequently be seen as worth incurring in light of the substance's benefits. (Think, for instance, of newly discovered health benefits of aspirin, notwithstanding that it causes some side effects.) A flat prohibition imposed on the substance that emerges from risk aversion today may affect marketing of the substance for a longer period than a rule that denies the use of "unreasonable substances," and thus prevent realization of the offsetting benefits, even though the two formulations have identical effects (banning use of the substance) if promulgated today, prior to our discovery of new benefits.

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48 The phenomenon of treating existing risk differently from new risks is addressed in Peter Huber, *The Old-New Division in Risk Regulation*, 69 VA. L. REV. 1025 (1983).

## VI. CONCLUSION

Legal rules are promulgated for particular times and places, and thus reflect our understanding of the relationship between factual predicates and justifications that exist at those times and places. But understandings, and perhaps the relationships themselves, may change subsequent to the promulgation of legal rules. If legal rules are to serve their intended function, those who draft and apply legal rules must have the capacity to perceive shifts in the underlying relationships and adjust legal rules accordingly. I have indicated some circumstances in which the nature of the legal rule frustrates that exercise.

More complicated is the issue of how to address that frustration. In some cases, different institutions may have different capacities to adjust the application of legal rules to changed circumstances. Thus, for instance, if we believe that courts can detect changes in the probabilistic relationship between factual predicate and justification, we may want to draft legal regulations in terms of broad standards rather than precise rules in order to permit *ex post* judicial determinations rather than *ex ante* legislative determinations of the appropriate scope of liability or responsibility. Alternatively, if legal presumptions embody political choices not easily reflected in ad hoc adjudication, then the rule might be best embodied in a rigid rule from which courts cannot easily deviate, since they will be relatively incompetent to obtain and evaluate empirical evidence that would justify overriding the presumption.

More radically, we might create sunset provisions for a broader range of laws in order to induce decisionmakers to recreate the initial analysis in order to determine whether it still holds. But the discussion of optimality suggests that such a step would only be appropriate if we thought that the problem of irreversibility was sufficiently significant to warrant incurring the costs related to re-enacting a wide array of law. If irreversibility is a sufficiently small problem, then this remedy might well be unwarranted, suggesting (not without irony) that the problem of irreversibility may itself be inherent in any legal system, or, irreversible.