

JUSTICE AND THE EVOLUTION OF THE COMMON LAW*

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“The first and chief design of every system of government is to maintain justice; to prevent the members of a society from encroaching on one another’s property, or seizing what is not their own. The design here is to give each one the secure and peaceable possession of is own property. — When this end, which we may call internal peace . . . is secured, the government will next be desirous of promoting the opulence of the state. (Adam Smith, Dec. 23, 1762, “Of Jurisprudence”)

I. INTRODUCTION

Empirical evidence shows, and theory suggests, that the common law tends toward economic efficiency.¹ While various theories attempt to explain this phenomenon, no single one is well accepted. This article provides a simple explanation.² It suggests that efficiency arises as a matter of justice seeking, as efficiency and justice wholly or substantially overlap. Judges discover just and efficient common law primarily through the adoption of norms but also of intellectual knowledge. When neither is available, justice is more difficult to determine. Judges seek justice because justice-seeking is a social norm with its own sanctioning force. Justice is sought but efficiency achieved because they substantially overlap.

Inefficiency is created by change and the faster the pace of change the less likely are norms and knowledge to relevant to determine efficiency to be available. Thus the less likely is

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¹ The evidence is too extensive to cite. Some of it is summarized in two textbooks, Cooter and Ulen (1997), and Posner (1992). Skepticism is evidenced in a series of articles by Mark Kelman, who sees the proposition as ideologically based. See Kelman (1988). The first attempt to provide an explanation can be found in Rubin (1977). Other explanations have come from Priest (1977), Goodman (1978), and Cooter & Kornhauser (1990).

² Cooter has expressed the view also captured here that social norms explain common law efficiency (1996). This view is also expressed in Zerbe (2001a). The authors have arrived at this view independently.

the common law created in period of rapid change to be efficient or just. Several examples are presented that exemplify this model of common law efficiency.

II. ECONOMIC EFFICIENCY IS ENHANCED WHEN ITS DEFINITION IS EXPANDED TO INCLUDE MORAL SENTIMENTS

A problem for the congruence between justice and efficiency is the arbitrarily limited definition of efficiency. Traditional efficiency fails to consider equity and more generally moral sentiments. Mainstream efficiency is defined by the criterion of Kaldor-Hicks (KH), which, by definition, eschews issues of equity and arguably moral sentiments, so that its perfect correspondence with justice is not to be expected. Thus it is not difficult to find common law examples that are not KH-efficient.³

Efficiency becomes both more powerful, useful and accepted through expanding the concept of efficiency to include equity by which I also include moral sentiments. This I and others have done elsewhere (Zerbe, 2001a, 2005, Zerbe Bauman, Finkle, 2006).⁵ I call this expanded criterion KHM, where the M represents moral sentiments.⁶ KHM represents a version of KH that includes, *inter alia*, moral sentiments.⁷ That is, all goods, including moral

³ For examples see Zerbe (2001a). The development of labor law might also be seen as an example of this (Lande and Zerbe, 1996)

⁵ In the 2001 work, I use the term “KHZ” which represents Kaldor-Hicks-Zerbe. Subsequently, I changed this to the more appropriate term KHM. In the 2005 work, “KHM” stands for Kaldor-Hicks-Moral.

⁶ Additional characteristics are (1) the use of the willingness to pay (WTP) for gains and the willingness to accept (WTA) for losses; (2) the use of WTP and WTA from a legal status quo; (3) the exclusion of gains or losses that are legally illegitimate, as with goods held by the thief, or that violate well-accepted moral principles (benefit-cost rationale is provided for this); (4) a recognition and inclusion of non-pecuniary effects; (5) an efficiency test that is passed when and only when the aggregate benefits exceed aggregate losses so that (6) there is no use of the potential compensation test; (7) an assumption of equal marginal utility of income so that each person is treated the same; (8) the absence of reliance on market failure or externalities to justify the use of benefit-cost analysis; (9) the inclusion of transactions costs of operating a project; and (10) an understanding that the role of benefit-cost analysis is to provide information to the decision process and not to provide the answer. This list of characteristics is explored more fully elsewhere (Zerbe, 2001a, and Zerbe et al., 2005).

⁷ KHM efficiency differs from KH by its clearer grounding in legal rights, by its inclusion of all sentiments for which there is a willingness to pay, by its abandonment of the potential compensation criterion for one of net benefits, by its reliance on transactions costs rather than market failure to determine where to apply benefit-cost analysis, by its inclusion of transactions costs of operating a project though not of the costs of institutional change, and by its view of efficiency as a technique to provide information relevant to the answer, not to provide the answer. This view is essentially identical to the view that has been presented elsewhere (Zerbe 2001a) as the KHZ view.

sentiments, are to be treated as economic goods as long as there is a willingness to pay for them or a reluctance to give them up.⁸ As this definition is more inclusive of sentiments generally, it will better correspond with the requirements of justice and thus is more likely to be consistent with the common law.

III. Justice and Efficiency

The following example is meant to illustrate the way in which KHM can amend the divergence between KH efficiency and justice.⁹ I shall say that justice arises from meeting reasonable expectations. Consider the location of a NIMBY, say a waste incinerator, in one of two neighborhoods; one neighborhood is rich, the other poor. The incinerator produces undesirable environmental effects and no corresponding benefits for the neighborhood so that neither neighborhood wants it. It is of course efficient to locate the incinerator in the poorer neighborhood. The land is cheaper, and the willingness to pay to avoid it is greater in the richer neighborhood. We can ask, however, if the poorer neighborhood should be compensated, monetarily or as with, say, the provision of a new park. Is compensation just? Certainly it can be seen as just as when society in general feels that compensation is the right thing to do since the expectation will be one of compensation.. Traditional efficiency has nothing to say about the issue. If moral sentiments are to be included, as required by KHM, then compensation is also efficient. Sentiments about compensation are a part of justice and are a part also of KHM, but

⁸ KHM differs from tautological efficiency, a concept introduced by Zerbe (1991) and Barzel (2000).⁸ Barzel (p. 241) explains tautological efficiency as a state in which "individuals must spend resources to discover inefficiencies and arrange to take advantage of their profit potential. Suppose that after taking account of these costs, some of these activities are still found profitable but some are not. The former will be eliminated whereas the latter will be allowed to stand. The latter ones, however, are not worth eliminating It is tautological that ... given profit maximization efficiency will prevail." Logically efficiency should further require that spending on discovery itself must be at the efficient level.

⁹ Generally it is thought that KH-efficiency does not include an evaluation of moral sentiments. This view is an extension of Kaldor's rejection of the consideration of distributional effects for benefit-cost analysis because of the mistaken notion that value judgments would be avoided by such exclusion. Some have further claimed that to include moral sentiments can lead to a failure to pass the potential compensation test and to double counting. These claims are, however, either incorrect or not a legitimate justification for ignoring moral sentiments (Zerbe, Bauman and Finkle, 2005). Rather, moral sentiments are fundamental to justice and should be for efficiency. Indeed one can show that a Pareto improvement can be rejected by KH because it does not include moral sentiments (Zerbe, Bauman and Finkle, 2005).

are not a part of a traditional efficiency analysis. A project with compensation is thus different from the same project without compensation under KHM.

Table One illustrates, from a benefit-cost perspective, the different analyses under KH and KHM of locating the incinerator in the poorer rather than the richer neighborhood. Table One assumes that the incinerator will be located in the poorer neighborhood. Compensation to the poorer neighborhood and mitigation of environmental effects are possible in three of the four scenarios, but are alternatives (such that only one can be chosen in each scenario).

BENEFITS AND COSTS	[1]	[2]	[3]	[4]
	No Compensation or Mitigation Occurs (thousands of dollars) (PV)	Compensation Occurs (thousands of dollars) (PV)	Mitigation Occurs (thousands of dollars) (PV)	Neither Compensation Nor Mitigation Are Feasible (thousands of dollars) (PV)
Benefits to Society	100	100	100	100
Ordinary Costs	60	60	60	60
Harm to Neighborhood	20	20	0	20
Mitigation Costs			21	--
Moral Harm to Non-Residents	50	0	0	50
Transfer Cost of Compensation	-	20	-	--
Administrative Costs of Compensation	-	2	-	
KH NPV	20	18	19	20
KHM NPV	-30	18	19	-30
Conclusion	Neither compensation nor mitigation appear worthwhile under KH, as moral harm is ignored	Compensation eliminates moral harm, which is relevant only under KHM	Mitigation eliminates moral harm, which is relevant only under KHM	Moral harm renders project undesirable under KHM but not under KH

* Note that not all figures are relevant to KH and that mitigation and compensation are substitutes, so that one or the other but not both are included in the AM calculation.

In column 1, the net present value (NPV) is a positive \$20,000 under KH because KH fails to count the costs arising from moral sentiments. The NPV of KHM is a negative \$30,000. In column 2, compensation is made to the poorer neighborhood for bearing the environmental costs of the incinerator. Moral harm is eliminated so that KH and KHM both give the same NPV of a positive \$18,000. In column 3, mitigation is made that eliminates the harm so that again the NPV under KH and KHM are the same (\$19,000). Under KH, however, economic efficiency will not lead to either mitigation or compensation as the NPV is greatest when neither mitigation nor compensation occur (column 1). KHM, however, leads to a choice of mitigation as this is the highest NPV including all sentiments. If neither compensation nor mitigation is feasible, KHM suggests the project be abandoned as the NPV is a negative \$30,000, while the KH analysis does not change. The Table shows that KH fails to convey relevant information. KH suggests putting the incinerator into the poorer neighborhood without compensation or mitigation.

Moral sentiments regarding the allocation of rights and goods must be included as a matter of justice if we are to have confidence that actions that pass a benefit-cost test are to be seen as welfare-enhancing and just. Without such inclusion, projects will be undertaken that do not increase net gains, counting the value of moral sentiments, and projects will be avoided that do increase net gains (Zerbe, Bauman and Finkle, 2005). The simple moral rationale for benefit-cost analysis (BCA) is that when it is applied broadly, everyone tends to gain. Those that lose from one project gain from another so that applied broadly and over time the use of efficiency criterion in policy can tend to make social policy Pareto-superior. This is, however, only possible when distributional effects, the sense of fairness and due process are considered goods in an efficiency analysis. Without the use of such goods in the analysis of efficiency, efficiency tends to separate from justice and it becomes less reliable. In the example of the location of a incinerator, the use of the usual efficiency criteria will lead to the incinerator being located in the poorer neighborhood without compensation, with the result of further degrading that neighborhood. The next time the city is faced with a decision based on willingness to pay or willingness to accept, the poorer neighborhood will be in an even weaker position to protect itself. This can lead to a downward spiral for those less well off and vitiate the moral standing of efficiency.

Justice is meeting reasonable expectations, and in a liberal society, reasonable expectations arise from existing rights. Given existing rights, it will be efficient to incorporate

changes in rights that increase aggregate well being. This is also a description of KHM efficiency. It rests on existing rights and, when applied broadly, tends to increase the welfare of all, when welfare includes those moral sentiments that are also an integral part of well-being.¹⁰ The simple moral argument for the use of efficiency to allocate resources is that its use has a reasonable chance to increase net wealth for the most people, particularly if applied with due regard for others' rights and moral sentiments. Losers from a project today will be winners tomorrow. The benefit-cost approach, by definition, results in an increase in wealth across all projects that meet the benefit-cost standard. As net wealth is increased, there is a clear potential for all to be winners; the systematic application of a net-benefits approach has some reasonable potential to satisfy a Pareto test at the end of the day.

IV. THE VALUE OF NORMS FOR JUSTICE AND EFFICIENCY

Reasonable expectations and thus justice arise largely from the extant set of rights and the perceived fairness of those rights. Making rights or ownership more complete for reasons that are well understood increases greater justice as well as efficiency. Ownership lowers transactions costs. First rights tend to be efficient as they reduce costly conflict. Second, rights rearrange valuations so that a change from them is less likely to be efficient. Ownership establishes a reference point from which losses are to be calculated by the willingness to accept (WTA) and gains by the willingness to pay (WTP). Benefits and costs are measured, respectively, by the WTP and by the WTA under KHM as well as under KH.¹¹ The WTP represents the amount that someone who does not own a good would be willing to pay to buy it; it is the maximum amount of money one would give up to buy some good or service, or would pay to avoid harm.¹² The WTA represents the amount that someone who owns a good would accept to sell it; it is the minimum amount of money one would accept to forgo some good, or to bear some harm.¹³ The measure of loss from a change in ownership is properly measured by the WTA and the gains

¹⁰ For a summary of fairness experiments, see Fehr and Schmidt (2001).

¹¹ See Zerbe and Dively (1994).

¹² These are non-technical definitions and, as such, are not wholly accurate. The compensating variation (CV) is the sum of money that can be taken away or given to leave one as well off as one was *before* the economic change. The equivalent variation is money taken or given that leaves one as well off as *after* the economic change. See Zerbe and Dively for a derivation of these concepts in terms of indifference curves.

¹³ The benefits from a project may be either gains (WTP) or losses restored (WTA). The costs of a project may be either a loss (WTA) or a gain forgone (WTP).

from a change by the WTP. For the same individual, the WTA for a good will equal or exceed the WTP. Thus, the measure of loss from a change of ownership will tend to exceed the measure of gain, *ceteris paribus*.

These representations of value apparently correspond with the associated psychological states of valuation. From a legal perspective, the use of the WTA to measure losses and the WTP to measure gains rests on a normative decision to recognize ownership. Ownership establishes a psychological state that efficiency must recognize because it is relevant for the calculation of gains and losses. Thus efficiency corresponds with the psychological states associated with ownership--that is with a set of reasonable expectations.¹⁴

One's sense of ownership will usually conform to one's knowledge of legal ownership. Most people feel that they have a moral right to what they legally own, and do not feel that they have the moral right to something they do not own. For most cases, then, the law will determine whether the WTP or WTA will be used even if the economic standard is psychological ownership. The common assumption is that a choice based on assigned legal entitlements will usually be correct, but it is correct because of the correspondence between the legal and psychological states; it is not correct as a matter of principle, and it is incorrect in important cases.¹⁵

Both efficiency and justice recognize legitimate ownership not only in the proper allocation of rights but in determining the calculation of gains and losses.¹⁶ For some time it has

¹⁴ Kahneman et al., 1979, 1990, 1991a, 1991b

¹⁵ Levy and Friedman (1994, p. 509) incorrectly assert "the determination of the conceptually appropriate form of CV query is a matter of property rights, not economics or psychology." This implies that the law ought to govern in the event of a conflict between rights given by law and those recognized as a psychological reference point. The authors use the term "CV query" in reference to questionnaire studies. "CV" here stands for "contingent valuation," not compensating variation. This result is contrary to economic efficiency. Economic efficiency in the KHM form would recognize the psychological status quo as primary and change ownership to conform to it. The psychological reference point is, however, not just that of the individual but of society generally, so that in so far as the law embodies the general understanding, Levy and Friedman are correct that the law should govern. Because the underlying basis is the general psychological reference point, however, where this differs from the law, it furnishes a guide for further development as indeed it has done with the development of common law

¹⁶ See Zerbe (2001b). This approach makes clear the irrelevancy of the critical legal studies objection to benefit-cost analysis as Heyne has shown. The KHM approach shows the failure of the critical legal studies argument that the measurement of benefits and costs is incoherent. Put briefly, the critical legal studies argument is that one cannot use the concept of efficiency without endorsing some concept of property rights, from which it is seen to follow that the concept of efficiency cannot be used to resolve

been recognized that the policy and welfare implications of any substantive economic analysis depend upon the legitimacy of the property rights that underlie the relevant supply and demand functions.¹⁷ Heyne (1988, p.11) notes that, “Because this legitimacy depends on existing law ... the foundations of economics may be said to rest in the law.” The legitimacy of ownership will in turn depend on moral sentiments about what is justly owned and rewarded. If the legitimacy of ownership allocations is then to conform to those suggested by efficiency, efficiency itself must recognize these moral sentiments.

In a sense, this has long been noted. Atiyah (1979) pointed out that David Hume and Adam Smith both said that expectations arising out of rights of property deserved greater protection than expectations in regard to something that had never been possessed. To deprive somebody of something which he merely expects to receive is a less serious wrong, deserving of less protection, than to deprive somebody of the expectation of continuing to hold something that he already possesses.¹⁸

The law has long recognized that it is more intrusive to stop an owner from conducting an ongoing activity than to prohibit the owner from undertaking the same activity if he has not yet begun it. The currently fashionable expression of this may be found in Justice Brennan’s phrase in *Penn. Central Trans. Co. v. City of New York*,¹⁹ that a restriction is more likely to cause a taking if it destroys “investment backed expectations.”

Norms confer a type of ownership status. Thus they tend to confer the same benefits of efficiency and justice as legal rights. Thus legal rights that build on norms will also conform to both expectations and a sense of what is deserved and will a fortiori promote efficiency and

disputes over property rights without begging the question. Benefit-cost analysis takes, as does the law, the existing structure of rights as extant. But there are disputes that reflect uncertainty about some small portions of these rights. Benefit-cost analysis merely furnishes information relevant to the legal decision about the allocation of such a right. Take a simple case: A change in technology makes valuable rights to the radio wave spectrum that has hitherto been unowned. No party has a superior claim. The assignment of the right to a particular party will be a gain. Gains in economic analysis are to be measured by the WTP. The WTP will in turn be partly determined by the pattern of wealth that rests on the existing system of rights. Economic analysis suggests auctioning off the right. The right in general should go to that party who would pay the most for it if transactions costs were zero. Cases where conflicting prior claims exist raise more difficult questions, but these are answerable and elsewhere I have provided answers. See Zerby (2001b).

¹⁷ *Id.* at 53–71.

¹⁸ See Atiyah (1979).

¹⁹ *Penn. Central Trans. Co. v. City of New York*, 438 U.S. 104 (1978). The author would like to thank William B. Stoebuck for this reference.

justice. . . When norms are well established, they are more likely to be efficient because the rights they establish will be more certain and accepted. Those rights that are long standing are more likely to be efficient than when those rights are contentious. Justice involves people receiving what they deserve and in meeting their reasonable expectations. Thus, justice suggests that those who contribute more should receive more, as a principle of efficiency. Norms will be more likely to be seen as uncontentious when they are seen as just and therefore as also efficient.

JUDGES ADOPT NORMS AS COMMON LAW BECAUSE THEY SEEK JUSTICE

Judges act according to a norm of justice.²⁰ According to Glick (1990), empirical evidence suggests that judges seek to do justice in deciding cases. As John Chipman Gray (1909, p. 114) points out, “The essence of a judge’s office is that he shall be impartial” A similar sentiment was expressed by the commission of four bishops, two earls and six other barons who were appointed after the triumph of Henry III over the baronial faction: “Furthermore, we ask the same lord king ... that, for doing and rendering justice, he will nominate such men as, seeking not their own interests, but of those of God and the right, shall justly settle the affairs of subjects according to the praise-worthy laws and customs of the kingdom” (Hogue, p. 67, citing *Dictum of Kenilworth*).

Posner’s (1990) view of judges is not apparently at variance with the one expressed here. Posner (1990, p. 17) notes that Holmes’s *The Common Law* (1881) is an extended paean to judges’ skill in adapting common law doctrines to durable public opinion. Durable public opinion, of course, is what we mean when we speak of norms. This opinion then helps to define efficiency, so that the efficiency of the common law, far from being unusual, should be expected. Judges act according to a norm — a norm that expects them to dispense justice;²¹ they use the language of justice. I will cite one example among almost endless possibilities because, first, it uses the language of justice; second, it illustrates the regard for others; third, it shows concern for the income distribution; and fourth, it keeps with my custom here of using historical references.

²⁰ This view is not universal. See, for example, Everson (1919) and Blanck (1996).

²¹ The trickier question, of course, is what it means to say that a judge should “do justice.” Under the jurisprudential doctrine of positivism, a judge does justice (especially in a democratic country) by following the “plain meaning” of statutes (Allen, 1992, p. 692). Under the natural law and legal realist theories of law, a judge does justice by recognizing either transcendent moral values (natural law) (Pennington, 1997, p. 1097) or public policy and common sense (legal realism) (Allen, p. 692).

In *Gilmore v. M'Kelvey* (MacDevitt, 1884, p. 10), a case arising out of the Irish land law of 1881, the court writes, "With respect to the question of value, the court is perfectly unanimous. One cannot help having a certain feeling with respect to a gentleman who having in 1878 voluntarily and without coercion taken a couple of fields outside the town from a lady, not very wealthy, at a rent of £30 a year, comes in the year 1882, and seeks to get a perpetuity in that land as against her at a rent of £12 15s. I have no doubt Mr. Gilmore reconciled himself to the transaction, *but there are many people who would not*" [emphasis added].

Attempts such as those of Landes and Posner (1975) to explain judicial behavior from an interest-group perspective are "simply unconvincing," as North (1981, p. 57) and Buchanan (1975) have pointed out. As Hogue (p. 253) states, "When judges in medieval England failed to maintain the high standards of learning and disinterested action expected of them, English feudal barons, churchmen, and merchants insisted on reform."

Efficiency itself is such an important norm that we should not be surprised when impartial judges advance changes in rules that are efficient. Gray (1909) argued that judges and jurists approached the law from the side of public welfare, and sought to adapt it to the common good. Holmes in *The Common Law* (1881) asserted that when revenge was a prevailing sentiment, the law provided a remedy for a wrong that approximated what would have been considered necessary to give victims their traditional vengeance. Later, when revenge became less important relative to the values of deterrence and compensation, the old doctrines were ingeniously adapted to the new sentiments (Posner, 1990).

The relationship between the British king and the judiciary may explain the norm in part. Efficient norms that promote the wealth of a nation are likely to increase the sovereign's wealth as well, and reduce dissention, and will tend to be then be left undisturbed.²² Thus, norms such as those requiring that debts be paid or that contracts be honored among citizens are wealth

²² A full explanation of the origin of the norm that judges should dispense justice would require a treatise on English history, which I do not provide I will, however, note that a straightforward extension of the work of Weingast (1997) and of Calvert (1995) suggests that a norm of justice arises as an equilibrium condition in a "game" that produces stable democracies. The equilibrium condition requires that citizens agree on the boundary of the state and that those boundaries be self enforcing (Weingast). In a game-theory setting, this occurs when constitutional or other provisions are held in sufficiently high esteem that citizens are willing to defend them. I note also that disturbing a norm is costly because it fuels opposition.

increasing, and will not be disturbed by the sovereign. The sovereign's judges have, then, an incentive to see that those norms become legally enforceable.²³

VI. ADOPTION OF UNCONTENTIOUS NORMS IS EFFICIENT

A norm is a set of rights or ownership established by custom. A norm contributes to efficiency by setting or clarifying rights (Zerbe and Anderson, 2001). When norms are well established they are more likely to be efficient because the rights they establish will be more certain. By definition, uncontentious norms are widespread, long established and without controversy (Blackstone, 1900). Norms lacking one of these elements are contentious. An uncontentious norm is more apt to be efficient than a contentious norm. Being without controversy such norms can reasonably be regarded as fair. Property rights established under an uncontentious norm are likely to be settled, accepted, better known and clearer than those established under a contentious norm. When uncontentious norms are in effect, it is less likely that an efficient rule change will exist.²⁴ If a rule is uncontentious, it is settled and enforced through social pressure.

A court that adopts uncontentious norms into the common law establishes legal property rights where they did not exist before and ensures that these legal rights correspond with established economic ownership. Suppose, for example, that the norm in a community is that group A has the right to collect driftwood along a certain beach to the exclusion of group B. Psychological ownership in driftwood among group A has been established. In the absence of knowledge that rights have been mis-specified by custom, the assignment of rights to A is more likely to be efficient. A's loss — were the right to be assigned to B — would be measured by its WTA, but B's gain would be measured by its WTP. Even if group B were the least-cost collector, the WTP may be less than the WTA of A if the right has more than purely commercial value. Assigning the right to A is likely to be the efficient assignment even if B is the least-cost collector. First, to assign the right to B, without compensation to A, when it has psychologically belonged to A, will be seen as unfair by others. Society members' moral sentiment that the rule

²³ Myers (1971, p. 1) notes the puzzling fact that England produced a more stable democracy earlier than other European countries but also had a stronger monarch earlier. This puzzle may be resolved by considering the role of norms. A stronger monarch produces a more uniform system of norms. This more uniform system will make it more difficult for the monarch to play off some groups against others.

²⁴ There is likely to be an exception to this statement when a rule change can harness the enforcement power of government and in this way improve on a norm.

change was unfair would be measured as an efficiency loss resulting from the assignment to B. Second, it will be expensive to determine that B is the least-cost collector. The main role for the courts in this sort of situation is simply to specify property rights and thus lower the transactions costs of A's selling the right to B, so that the right is more likely to transfer. When the existing psychological ownership is accommodated, any transfer from the group with psychological ownership will be compensated, and thus will be more likely to be seen as fair.

A court's decision to reallocate a right away from party A, who holds psychological ownership, to party B would involve greater risk. To determine that it is more efficient to assign a right to party B, the court would need to determine that the right was worth more to B than to A, and this determination would be both expensive and error-prone. The court knows, moreover, that if it allocates rights according to existing social norms, parties will likely reallocate rights to resolve any inefficiency if transaction costs are low enough.²⁵ The court recognizes that any loss caused by allocating the right to collect driftwood to party A instead of party B is limited to the transaction costs of transferring the property right. These transaction costs are likely to be less than the costs of having the courts attempt to determine whether B is the efficient holder of the right. Thus, granting the right to A rather than to B and following the norm is more likely than not to result in efficiency.

VII. THE COMMON LAW INCORPORATES LONG-STANDING CUSTOM

To establish rights that correspond to economic ownership when conditions are unchanging is by definition efficient. Norms that are uncontentious and long-standing involve the establishment of economic rights. When law adopts a norm, legal ownership corresponds to and codifies economic ownership. When conditions change, the common law seeks an efficient adoption of norms and may or may not find one, depending on the pace of change and the corresponding difficulty of determining the efficient rule.²⁶ A wide variety of common law was developed by judges in response to such scenarios (Cohen and Knetsch, 1992).

²⁵ Transaction costs may be prohibitively high in the case of public goods.

²⁶ Underlying this proof is a notion that preferences are to be taken as given. It is true that in benefit-cost analysis, preferences are usually taken to be given. However, efforts to change the law to accord with preferences may themselves be KH-efficient. Underlying this proof is the notion that changing preferences to be in accord with the law cannot be described as efficient.

In his treatise, Blackstone (pp. 56-57) provided a list of criteria judges should consider before codifying norms into the common law. Blackstone contended that norms must be long-established and uncontentioned before being incorporated into the common law. According to Plucknett (1956, p. 308), the civilian jurist Azo was held in high esteem by Bracton, and Azo noted that “a custom can be called long if it was introduced within ten or twenty years, very long if it dates from thirty years, and ancient if it dates from forty years.” This requirement helped ensure that the public’s willingness to accept the changes was greater than their willingness to maintain the status quo (Blackstone). Blackstone suggested that prior to codifying a norm, a social sanction for failure to obey the norm should already exist in order to guarantee that only important customs became enshrined into law. Thus, Blackstone’s criterion ensured the incorporation of only true norms, which are norms that are efficient.²⁷

Judges have historically sought out custom to incorporate into common law. One of the earliest attempts to codify social norms was made by Lord Mansfield, who acted as chief justice of the court of King’s Bench in England from 1756 to 1788. During his tenure, Mansfield adeptly incorporated the merchant law into the common law; thus fashioning what had been a body of special customary law into general rules within the common law (Hogue, 1966). Hogue (pp. 248-249) noted that, “When a case touched commercial law, [Mansfield] saw to it that reputable merchants of the city of London formed the jury. Thus he secured in his court the participation of jurors who presumably understood every detail of material evidence. Outside court, on social occasions, he cultivated the acquaintance of merchants to acquire for himself a precise knowledge of their ways of doing business.”²⁸

VIII. INEFFICIENCY ARISES FROM A CHANGE IN CONDITIONS

A law will be more just and efficient as it is more fit and complete. A law is complete if it specifies all relevant rights. It is fit to the extent that the particular specification of rights is efficient. . Consider a static society in which all rights are specified. By static society I mean one that in which there is nor change in technology, sentiments of knowledge. This society will be efficient to the extent that transactions allow. In so far as transactions costs can be lowered through private innovation or through government intervention, profit seekers will lower them,

²⁷ Again, Blackstone’s (1800, pp. 56-57) norms represent the ideal along a continuum, not a rigid requirement.

again to the extent that the transactions costs of political action allow. Thus such a society is efficient in that it can be not improved upon.

An increase in inefficiency, in such a static society with a norm of justice, arises from and only from changing conditions. Again I refer to changes in sentiments, technology, or knowledge.²⁹ The deterioration rate of a law or norm in terms of fitness and completeness will be a positive function of the rate of change. Thus in a static society there is no increase in inefficiency and the base level of inefficiency is limited by experience. Similarly, a rule that adopts uncontentious norms is almost certainly efficient, where conditions are not changing.³⁰

For example, suppose residents in a hot climate have no right to run noisy air conditioners without approval of their neighbors. That is this law is complete. Suppose it is not fit since the aggregate WTP to run noisy air conditioners is significantly greater than the WTA payment to allow them to be run. Overheated residents are able to purchase or obtain approval from their neighbors, but transactions costs are higher and the net social surpluses are lower than they would be if all residents had the right to run air conditioners. In considering a challenge, the court will note that the custom is for users of air conditioners to purchase the right to run them in many cases. The court, relying on custom, will then find a right to use air conditioners as a matter of common law and both justice and efficiency will be served.

Similarly suppose that air conditioners are a new invention and that the right to their use is unclear. The law is not complete. In a hot climate, the likely custom will be that people will use their conditioners and complaints about their noise will be generally disregarded. Again the courts, relying on custom, would under traditional common law procedure create a right of use. Thus custom in a static society will suggest what changes are efficient so that a static society will tend toward efficiency.

²⁸ See also Plucknett (1956, pp. 350, 664).

²⁹ It has been suggested to me that changes in the extent to which foreigners operate in the society would also affect efficiency.

³⁰ Thus, Ellickson's (1991) discussion of the conditions under which norms are efficient, and his discussion of why norms in whaling and norms with respect to wandering cattle are more efficient than other hypothetical norms, fails to recognize that, by definition, norms are efficient if they are stable and uncontentious. Ellickson's own examples, if read from the perspective illustrated here, demonstrate just this point. His interesting discussion indicates why norms of closely knit groups may be different from those of more diverse groups, and why it might be better to belong to a closely knit group than not; but it does not explain why norms are efficient.

In a static society, better evidence will exist about which result among competing outcomes and legal rules is efficient. Unchanging conditions over time will provide cleaner and less ambiguous information. As society members gather knowledge about mis-specified rights, pressure arising from a sense of fairness and justice, as well as self-interest, will build to change existing rules. Knowledge will become cheaper to acquire with time. As the price to attain additional knowledge decreases, rules will be changed to reallocate mis-specified rights. Judges will adjust rights at common law as a matter of justice so that society becomes KHM-efficient. The level of residual inefficiency in a static common law society that adopts norms will be limited by transactions costs that prevent an efficient trade. If transactions costs are sufficiently high that no trades take place when the right is mis-specified, there will be no norm to examine and some residual of inefficient rights might remain.

IX. THE GREATER THE PACE OF CHANGE, THE LESS LIKELY IT IS THAT THE COMMON LAW WILL BE EFFICIENT

Changes in sentiments, technology and knowledge create a dynamic world that guarantees both the existence and continual creation of inefficiencies. With change, laws tend to become less complete and less fit. A social change may render a previously efficient rule inefficient when the change results in ambiguous ownership, as with the discovery of a new valuable resource created by new technology or knowledge. Similarly a change in moral sentiments may make a change in ownership efficient as when the exercise of a right that harms others is no longer seen as acceptable. Thus, generally it is efficient to change the legal precedent only when conditions change.

A change in conditions creates inefficiencies and a more rapid change will create greater inefficiencies. A change in conditions implies, as North (1981) noted, a change in relative prices. As relative prices change, behavior will change in response, as will the efficient equilibrium. North explains historical change on the basis of just such responses to changes in relative prices. More rapid change increases the pressure for efficient rule changes but may also increase the costs of discovering which rule changes are efficient. Hogue notes that in every generation both lawyers and laypeople seem to have been drawn toward two desirable — but separate and contradictory — goals. The first of these is the goal of permanence, stability, and

certainty in legal doctrines. The second is the goal of flexibility and adaptability, permitting adjustment of the law to social necessity.³¹

The slower the pace of change, the easier it is for changes in custom to precede law. The slower the pace of change, the easier it is for judges to accurately determine the social standards of the age and incorporate custom into law. Thus, one would expect common law to be more efficient in a quieter age.³²

Efficiency in law is found through completeness and fitness. Inefficiency arises from a change in conditions that increases incompleteness and reduces fitness. As conditions change, the law or custom loses both completeness and fitness. The rate at which new issues are raised in a particular area of the law will be a positive function of both the level of incompleteness and lack of fitness in those areas of the law. The rate of new cases will increase as the net gains from a change toward greater efficiency increases, and the law's injustice increases. As law becomes less just, advocates that seek greater efficiency and justice will have greater chances of persuading judges who value justice. If custom changes, yet has time to become settled and uncontentious, custom will be a guide to efficient changes in the law. Otherwise, intellectual knowledge may be a guide. By this process, judges adopting new law by adapting either new custom or new intellectual knowledge will tend to create efficient common law precedent.³³

³¹ Hogue (p. 8) also notes that “[t]he result of the pull in these two directions has been an unresolved tension between factions, parties, or groups of men; not always a tug-of-war between conservatives and radicals. The dual objectives can exist in the legal thought of a single jurist.”

³² It does not follow, however, that the common law should not be used in eras of rapid social change. Just as the common law runs into trouble during eras of rapid social change, so too would any other system of law that attempted to match norms and laws. In a civil law system, judges are simply administrators, and play little or no role in creating law. In such a system, it is the legislature that would run into trouble, as it attempted to find an uncontentious norm when no uncontentious norm existed. If either a common law or civil law country attempted to ignore norms, this would create inefficiency, by definition.

³³ La Porta et al (1998) have found that law enforcement with respect to investor protection is stronger in common law systems: “there is no clear evidence that different countries favor different types of investors; the evidence rather points to a relatively stronger stance favoring all investors in common-law countries” (p.1151). Moreover, as La Porta et al note, recent evidence suggest that stronger protection promotes economic growth (p. 1152). That is, in my terminology, common law countries show greater fitness with respect to investor protection. This result is what we would expect if judges seek justice in common law countries, if we might also suppose that the path to justice through legislation is more time consuming than through changes to the common law, at least in situations where the adjustment to efficiency is gradual rather than heroic. Legislatures are more likely to respond to interest group considerations than are judges that seek justice.

Custom has changed over time, and the law has changed with it. Plucknett (p. 308) notes, “The Middle Ages seem to show us bodies of custom of every description, developing and adapting themselves to constantly changing conditions.” He continues, “Indeed nothing is more evident than that custom in the Middle Ages could be made and changed, bought and sold, developing rapidly because it proceeded from the people, expressed their legal thought, and regulated their civil, commercial and family life.”

The more rapidly conditions change, there is less opportunity for uncontentious norms to develop and the more difficult it is for judges to determine what is in fact efficient. When conditions change more rapidly, there may be no particular custom or norm that the common law can incorporate. There may be, however, reasonable generalizations from existing particular customs that represent the reasonable expectations of rights-holders and that are thus efficient. There will also be general norms or general custom that can be applied, although it may be doubtful that a general norm will be superior if a particular norm exists. By “general custom,” I refer to general norms that may be regarded as principles. Such norms may include an expectation that one is entitled to what one earns, that promises should be honored, or that equals should be treated equally.

When social conditions change, the analogy between past cases and the current issue may become strained, which may make it difficult for the parties to predict how the law will be applied to a current dispute. The harder it is to predict how a law will be interpreted, the higher transactions costs will be, as lawyers and experts are enlisted as consultants (in the hopes of avoiding a lawsuit) or litigators (after a lawsuit begins).

To substitute for loss of uncontentious custom in a period of rapid change, judges will seek evidence of efficiency in intellectual knowledge. Such a source will, as with common law, be more reliable the more settled it is and the longer such settled knowledge has lasted. Changing conditions will increase inefficiency through incompleteness and lack of fitness more rapidly than custom or intellectual knowledge can answer for so that legal inefficiency increases. In the more modern era, when the pace of changes in conditions has been more rapid, greater reliance undoubtedly has been placed on judicial judgment of what is efficient, as compared with well-established custom in the development of efficient common law. As Friedman (1959, p. 26) notes, “Since the First World War the tempo of social change has accelerated beyond all

imagination. With it the challenge to the law has become more powerful and urgent.”³⁴ Today, courts recognize that the law must change in response to changes in sentiments, knowledge, and custom. For example, the U.S. Supreme Court noted in 1997 that antitrust law must change to reflect “new circumstances and new wisdom,” and that the common law cannot remain “forever fixed where it was” in a previous era.³⁵ The problem is that in a period of rapid change it is more difficult for a judge to determine whether sentiments, knowledge, or customs are changing, and to determine the course of their change (Friedman 1959). These propositions will be examined through the following case studies.

X. EXAMPLES OF THE INTERACTION OF COMMON LAW AND NORMS OF JUSTICE

I have suggested that the law achieves justice by adopting uncontentious norms. I have suggested that the common law tends toward efficiency and that this tendency will be more successful in a quieter age. Logic and analysis can be, and has been, imperfectly substituted for the experience of norms in the modern age where norms are less available, as seen in the example of vertical integration in antitrust law. When economists and lawyers ignore considerations of justice, as when moral sentiments are ignored, the normative analysis is flawed and the correspondence between efficiency and the common law is less apparent. This is illustrated by a consideration of slavery and of dueling in the antebellum South. When no such norms are available, the efficient law is difficult to determine. This is illustrated by the cases dealing with segregation and the law of nuisances discussed below.

A. A Change in Knowledge: Antitrust Law

Even though a federal statute governs antitrust law, it is generally accepted that courts supply the content of the antitrust law by creating an antitrust “common law.”³⁶ In deciding antitrust cases, courts recognize that the law should change to reflect new economic theory and data.³⁷

³⁴ Friedman (1959, p. 26f) notes the law’s response to some of these changes. Examples of common law adapting to change may be found in *McPherson v. Buick*, 217 N.Y. 382, 111 N.E. 1050 (1916).; *Donoghue (or McAlister) v. Stevenson*, [1932] All ER Rep 1; [1932] AC 562; *House of Lords (1932)*. A host of similar examples are mentioned by Friedman.

³⁵ See *State Oil v. Khan*, 522 U.S. 3, 21 (1997).

³⁶ See *Khan*, 522 U.S. at 20, 21.

³⁷ See *id.*

Changes in knowledge have made it efficient to change the law of vertical restraints. In antitrust vernacular, a “vertical restraint” is an attempt by a manufacturer to control the activities of wholesalers, distributors, or retailers. There are two basic categories of vertical restraints. First, there are price restraints, where the manufacturer sets either a minimum or a maximum price at which a retailer may sell its products to customers. Second, there are non-price restraints, where the manufacturer limits the customers to whom a retailer may sell its products. Non-price restraints usually take the form of territorial restraints, where a retailer is given an exclusive right to sell the manufacturer’s product within a certain area, in return for promising not to sell the product to any customers outside of the area.

Horizontal restraints, on the other hand, refer to agreements between firms at the same level — i.e., two or more manufacturers *or* two or more retailers — not to compete. Like vertical restraints, horizontal restraints usually involve either price-fixing or territorial market divisions.

Although the Sherman Antitrust Act³⁸ prohibits “every contract, combination, or conspiracy” to suppress competition, the courts quickly realized that every contract suppresses competition in some sense (because an agreement to sell 100 widgets to one person is an implicit agreement not to sell those particular widgets to anybody else) and that Congress could not have intended to outlaw every business agreement, or even every agreement between competitors.³⁹ Therefore, courts developed a “rule of reason,” stating that only “unreasonable” restraints — those that harm competition more than they benefit it — are violations of the antitrust laws.⁴⁰ On the other hand, the courts realized that some types of agreements — such as horizontal price-fixing — were so likely to harm competition that an in-depth analysis of each one was not justified.⁴¹ Such agreements are unlawful “per se.” If it is proved that a defendant engaged in an agreement subject to the per se rule, the defendant will be punished, and cannot escape liability by arguing that his agreement had pro-competition effects. In holding that a type of agreement is unlawful per se, the court is essentially making an economic *prediction* that the probability that an agreement of that type would injure competition is so much greater than its probability of benefiting competition that it is not worth the court’s time to analyze the competitive

³⁸ 15 U.S.C. §§ 1-7 (2005).

³⁹ See *Chicago Board of Trade v. United States*, 246 U.S. 231, 238 (1918).

⁴⁰ See *United States v. Standard Oil Co. of New Jersey*, 221 U.S. 1, 59-60 (1911).

⁴¹ See *Northern Pacific Railroad Co. v. United States*, 356 U.S. 1, 5-6 (1958).

consequences of a particular agreement of that type.⁴² Therefore, economic theory greatly aids judges who must decide whether to hold a type of agreement unlawful per se.⁴³ In characterizing an agreement as unlawful per se, the court is denying the defendant economic standing: indeed, Justice Harlan once noted in dissent that the per se rule is a “no trial rule.”⁴⁴

The first Supreme Court case involving a vertical restraint, *White Motor Co. v. United States*, was not decided until 1963.⁴⁵ In *White Motor Co.*, a truck and auto parts manufacturer placed both price and non-price restraints on distributors.⁴⁶ The government argued that both the price and non-price restraints should be subjected to the per se rule, and the lower court agreed.⁴⁷ White Motor Company did not contest the ruling that vertical price-fixing was illegal per se, but it did argue that vertical non-price restraints should be governed by the rule of reason. The Supreme Court agreed with White Motor Company. Specifically, it held that because the application of the per se rule is a prediction that agreements of a certain type are almost always profoundly anticompetitive, the per se rule should not be applied to a type of agreement that the courts did not have enough experience to make a reliable prediction.⁴⁸ In other words, the court decided that too little was known “about the economic and business stuff out of which [non-price restraints] emerge” to say with certainty that vertical non-price agreements would almost always harm competition.⁴⁹ Therefore, the court remanded the case to the district court to determine whether White Motor Company’s non-price restraints could be justified under the rule of reason.⁵⁰ Specifically, the court speculated that vertical non-price restraints, unlike horizontal territorial restraints, might benefit competition by allowing small companies to break into a business, and such restraints might be necessary to save a failing manufacturing company.⁵¹

Four years later, in *United States v. Arnold, Schwinn & Co.*, the Supreme Court imposed the per se rule on vertical non-price restraints, unless the restraint was part of a consignment

⁴² See *Khan*, 522 U.S. at 10.

⁴³ *Id.*

⁴⁴ See *Albrecht v. Herald Co.*, 390 U.S. 145, 159 (1968).

⁴⁵ *White Motor Co. v. United States*, 372 U.S. 253 (1963).

⁴⁶ See *id.* at 257-259.

⁴⁷ See *id.*

⁴⁸ See *id.* at 263.

⁴⁹ *Id.*

⁵⁰ *Id.*

⁵¹ *Id.*

contract.⁵² Schwinn manufactured bicycles and sold them through retailers. About 75 percent of the sales to retailers were characterized as “consignment contracts,” while the other 25 percent were described as “sales contracts.” Both the consignment and sales contracts with retailers placed territorial restraints on the sellers’ ability to sell the bicycles.⁵³ The court apparently felt that it had become familiar enough with vertical non-price restraints to make a reliable economic prediction about their competitive effect.⁵⁴ It began its analysis by interpreting *White Motor Co.* narrowly, stating that *White Motor Co.* extended the rule of reason to non-price restraints only when the manufacturer was a new, small company or a failing business, noting that Schwinn was neither.⁵⁵

In analyzing the competitive effect of vertical non-price restraints, the *Schwinn* court concluded that some small companies could compete with manufacturing giants only if they could offer dealers exclusive sales contracts which involved vertical non-price restraints.⁵⁶ On the other hand, the court felt that “prudence” dictates that it would be foolish to allow a company to give a dealer an exclusive contract while retaining “title” to and “dominion” over the goods.⁵⁷ Therefore, the court compromised by applying the rule of reason to non-price restraints in consignment contracts, but applied the per se rule to restraints in sales contracts.⁵⁸ The court justified this compromise by arguing that it was consistent with the “ancient rule against restraints on alienation.”⁵⁹ The court dismissed Schwinn’s argument that its exclusive dealerships enabled it to compete more effectively with larger competitors, because Schwinn was not a failing business.⁶⁰

⁵² See *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365, 379 (1963). In a consignment contract, a manufacturer delivers a product to a distributor, but retains title to the product until it is actually sold to a customer. The distributor keeps some of the sales money for itself, and sends the rest to the manufacturer, at a previously agreed upon ratio. See *id.*

⁵³ See *id.*

⁵⁴ See *id.* at 373-374.

⁵⁵ See *Schwinn*, 388 U.S. at 374-375; *White Motor Co.*, 372 U.S. at 263.

⁵⁶ See *Schwinn*, 388 U.S. at 379. This is almost certainly a misreading of *White Motor Co.*, since there is no evidence that White Motor Company itself was a new company or a failing business. See *White Motor Co.*, 372 U.S. at 263. The references to new companies and failing businesses were intended to be *examples* of situations in which the rule of reason might be satisfied, not to constitute an *exclusive* list. See *id.*

⁵⁷ See *Schwinn*, 388 U.S. at 378-379.

⁵⁸ See *id.* at 379.

⁵⁹ See *id.* (emphasis added).

⁶⁰ See *id.* at 374-375.

Justice Stewart, in a forceful dissent, argued that the majority’s reliance on an “ancient” rule to resolve a difficult antitrust issue was misplaced, because the fact that there was an “ancient” rule against restraints on alienation is of little help in predicting whether a vertical restraint will benefit competition today.⁶¹ He noted that, in any event, the “ancient” rule against restraints on alienation outlawed only unreasonable restraints, and therefore operated much more like the rule of reason than the per se rule.⁶² He agreed with the majority — and Schwinn — that being able to offer exclusive dealerships would be necessary if a company was to attract quality retailers and distributors, but he felt that whether a transaction with a retailer was characterized as a consignment or a sales agreement made little practical difference in the manufacturer’s ability to restrict competition, and therefore should not determine whether an agreement violates the antitrust laws.⁶³

One year later, the Supreme Court extended the per se rule to vertical price-fixing agreements, in *Albrecht v. Herald Co.*⁶⁴ *Albrecht* involved a newspaper company that terminated a paperboy’s route when he charged more than the maximum price specified in its contract with him.⁶⁵ Although the price the *Herald* set was not predatory, and the *Herald*’s low prices would obviously benefit its consumers, the court applied the per se rule,⁶⁶ offering three justifications. First, the court noted that part of the purpose of the antitrust law is to preserve an entrepreneur’s independent business judgment, and that an entrepreneur’s judgment was restricted regardless of whether he was forced to offer low prices or forced to offer high prices.⁶⁷ The court insisted that a firm should not be able to substitute “the perhaps erroneous judgment of the seller for that of the competitive forces of the market.”⁶⁸ Specifically, a manufacturer might set prices so low that the dealer was unable to make a profit, or it might set prices that would prevent the dealer from offering essential services to customers.⁶⁹

Second, the court argued that the *Herald* could not justify its maximum-price-setting rule on the ground that it protected consumers from paperboys who themselves enjoyed a monopoly,

⁶¹ See *id.* at 392.

⁶² See *id.* at 391.

⁶³ See *id.* at 388, 391.

⁶⁴ 390 U.S. 145 (1968).

⁶⁵ See *id.* at 147-148.

⁶⁶ See *id.* at 154.

⁶⁷ See *id.* at 152.

⁶⁸ See *id.*

⁶⁹ See *id.* at 152-153.

because it was the *Herald* that granted the paperboys a monopoly in the first place.⁷⁰ In other words, if the *Herald* argued that an exclusive paper route gave a paperboy monopoly power that he could use to demand super-competitive prices, the correct solution was to refuse to give him an exclusive paper route in the first place, not to grant it and then make the additional anticompetitive act of price-fixing.

Third, the court noted that a maximum-price-setting agreement might actually be a minimum-price-setting agreement in disguise.⁷¹ That is, a manufacturer might characterize something as a maximum price in a contract, but the dealers might realize that the manufacturer *really* wants them to charge that price at a minimum.

Justices Harlan and Stewart, in dissent, argued that all three of the court's justifications for the per se rule were economically naive. First, Justice Stewart pointed out that the antitrust laws are not concerned with protecting the independent business judgment of an entrepreneur when the entrepreneur is exercising monopoly power.⁷² In fact, the paperboy's "business judgment" is less likely to be consistent with the needs of the market than the *Herald's*, because a paperboy will complain about a reasonable maximum price only when it prevents him from charging a super-competitive price to consumers.⁷³ Justice Harlan argued that, in any event, a company could completely eliminate independent entrepreneurs by hiring its own sales employees, and while such an act would not violate the antitrust laws in any way, it would be more destructive to competition than the *Herald's* modest price-ceiling rule.⁷⁴ Second, Justice Stewart asserted that a paperboy's exclusive territory was most likely a natural monopoly, which was a product of the market's inability to support more than one paperboy per territory, rather than a grant of monopolistic power by the *Herald*.⁷⁵ Third, Justice Harlan pointed out that while it might be true that some maximum-price agreements are disguised minimum-price agreements, many maximum-price agreements are not.⁷⁶ In deciding whether to apply the per se rule to

⁷⁰ See *id.* at 154.

⁷¹ See *id.* at 153.

⁷² See *id.* at 169.

⁷³ See *id.*

⁷⁴ See *id.* at 160-161.

⁷⁵ See *id.* at 169.

⁷⁶ See *id.* at 165-166.

maximum-price agreements, he noted that the question “is not whether dictation of maximum price is ever illegal, but whether it is always illegal.”⁷⁷

*Continental T.V., Inc. v. GTE Sylvania, Inc.*⁷⁸ reversed *Schwinn*,⁷⁹ and held that vertical non-price restraints should be subjected to the rule of reason. The *Sylvania* court noted that *Schwinn* had been wrongly decided for a number of reasons.⁸⁰ First, *Schwinn* ignored *White Motor Co.*’s warning that a per se rule was justified only when a court had sufficient experience with a business practice to make a reliable economic prediction about its consequences.⁸¹ The majority in *Schwinn* did not identify any new information that had not been available at the time of *White Motor Co.*, yet it changed the rule.⁸² Instead, *Schwinn* attempted to resolve its difficulties by turning to “ancient” common law distinctions.⁸³ Second, to the extent that there was data that was available to *Schwinn* that had not been available in *White Motor Co.*, that data strongly indicated that a per se rule against vertical non-price restraints would be inefficient, and possibly even disastrous.⁸⁴ Third, developments in economic theory after *Schwinn* strengthened the case that a per se rule against vertical non-price agreements was a mistake, and that a rule that distinguished between consignment and sales contracts was wrongheaded.⁸⁵ In fact, it was the large companies with little legitimate need for exclusive dealerships that were most likely to be able to characterize their transactions as consignment contracts, and the small companies with a strong need to offer exclusive dealerships that were least likely to be able to do so.⁸⁶

In general, most economists became convinced that because interbrand competition was more important to consumer protection than intrabrand competition, a manufacturer’s interests were more likely to be consistent with the public’s interest than a distributor’s or a retailer’s interests were likely to be.⁸⁷ For example, vigorous interbrand competition ensures that a dealer with an exclusive territory cannot exploit his monopoly power, because a consumer would turn

⁷⁷ See *id.*

⁷⁸ 433 U.S. 36 (1977).

⁷⁹ *Schwinn*, 388 U.S. 365 (1963).

⁸⁰ See *Sylvania*, 433 U.S. at 59.

⁸¹ See *Sylvania*, at 47-48; *White Motor Co.*, 372 U.S. at 263; *Schwinn*, 388 U.S. 365.

⁸² See *Sylvania*, at 47-48; *Schwinn*; *White Motor Co.*

⁸³ See *Sylvania*, at 53; *Schwinn*, at 380.

⁸⁴ See *Sylvania*, at 53; *Schwinn*, at 382-394.

⁸⁵ See *Sylvania*, at 48-49; *Schwinn*.

⁸⁶ See *Sylvania*, at 56.

⁸⁷ See *id.* at 52.

to a different brand name rather than pay super-competitive prices.⁸⁸ Additionally, economists noted that exclusive dealerships allowed a manufacturer to eliminate “free riders” who might dissuade retailers from offering vital services and repairs, or from marketing the manufacturer’s products.⁸⁹ As the economic evidence mounted that *Schwinn* had been wrongly decided, and as more and more scholars advocated its reversal, it became increasingly efficient to reverse the decision. Because *Sylvania* explicitly relied on the expertise of economists, and recognized that it is desirable to change a common law rule when new knowledge suggests that the old rule is inefficient, *Sylvania* has been hailed as a turning point in antitrust legal history, and the beginning of modern antitrust analysis (Calkins, 1997).⁹⁰

The recent case of *State Oil Co. v. Khan* reversed *Albrecht*.⁹¹ *Khan* noted that none of *Albrecht*’s “dire predictions” of what would happen if vertical price maximums were legal were founded in fact, and that *Albrecht* had created additional problems.⁹² In essence, Justice Harlan’s predictions about the probable effects of *Albrecht* were borne out by the court’s subsequent experience.⁹³ *Albrecht* actually contributed to the elimination of independent entrepreneurs, because it encouraged manufacturers to replace dealers with sales employees.⁹⁴ Further, many economists concluded that *Albrecht* had hurt consumers, because a dealer was considerably more likely to set a super-competitive price than a manufacturer was likely to set a sub-competitive price, because the latter either prevented dealers from making a reasonable profit or prevented them from offering services that consumers desired.⁹⁵ Also, *Albrecht*’s logical underpinning was undercut by *Sylvania*: because it was now lawful, in many circumstances, to give a dealer an exclusive territory, it seemed foolish to prevent the manufacturer from protecting consumers by setting a maximum price.⁹⁶ Finally, the court agreed with Justice Harlan that the possibility that a maximum price was a disguised minimum price was hardly a justification for outlawing all

⁸⁸ See *id.*

⁸⁹ See *id.* at 55.

⁹⁰ *Id.* at 47-48.

⁹¹ See *Khan*, 522 U.S. 3 (1997).

⁹² See *id.* at 19.

⁹³ See *id.* at 19.

⁹⁴ See *id.* at 16-17.

⁹⁵ See *id.* at 17-18.

⁹⁶ See *Khan*, 522 U.S. at 14; *Sylvania*, 433 U.S. 36; *Albrecht*, 390 U.S. 145.

maximum-price agreements.⁹⁷ Under the rule of reason, the court could identify any alleged maximum-price agreement that was actually a minimum-price agreement.⁹⁸

In conclusion, a survey of the line of antitrust cases dealing with vertical restraints reveals two changes over time. First, there is a shift in the Supreme Court's attitude toward the significance of new economic knowledge.⁹⁹ *Schwinn* quite consciously chose an "ancient" rule to draw a line on a difficult economic issue, and turned its back on recent economic knowledge.¹⁰⁰ *Albrecht* similarly cited a "noneconomic" concern: protecting the independent business judgment of dealers.¹⁰¹ *Sylvania* and *Khan*, in contrast, recognized the importance of new economic knowledge, because the decision whether to apply the per se rule is an economic prediction about an activity's impact on the marketplace.¹⁰² Second, there was an increase in the availability and prominence of economic literature discussing antitrust law. In fairness to the *Schwinn* court, the volume of economic literature that was available to assist courts in deciding whether to extend the per se rule was much smaller than it was at the time of *Sylvania*. Indeed, *Schwinn* itself provoked a great deal of the economic literature relied upon in *Sylvania*.¹⁰³

B. A CHANGE IN SENTIMENT — THE EXAMPLES OF SLAVERY, DUELING AND SEGREGATION

It is easy to find examples where the common law is efficient,¹⁰⁴ but it is almost as easy to find examples where it is not.¹⁰⁵ The following examples discuss the difficult formation of common law under changing conditions. The first, dealing with the law of dueling, shows the relationship

⁹⁷ See *Khan*, at 17; *Albrecht*, 390 U.S. at 165-166.

⁹⁸ See *Khan*, at 17.

⁹⁹ It is worth noting that in the early cases there are virtually no references to the economic literature, while the later cases are peppered with them.

¹⁰⁰ See *Schwinn*, 388 U.S. at 380.

¹⁰¹ See *Albrecht*, 522 U.S. at 152, 158. In fact, the existence value of independent businesspeople is an "economic" good, but *Albrecht* does not discuss the value of independent business judgment in economic terms. See *id.*

¹⁰² See *Khan*, at 21; *Sylvania*, 433 U.S. at 54.

¹⁰³ See *Sylvania*, at 47-48; *Schwinn*, 388 U.S. 365.

¹⁰⁴ For example, the general common law rule that a landowner is not liable for negligently harming a trespasser is probably efficient. The exceptions where a landowner is liable to a trespasser are probably efficient as well.

¹⁰⁵ The law of mining and significant pieces of labor law come to mind (Lande and Zerbe, 1996).

between changes in sentiments and changes in law.¹⁰⁶ The second shows the attempt of the court to craft an efficient rule to deal with changing sentiments about the importance of sunlight and changing technology for converting sunlight into energy. The third example, the development and demise of the “separate but equal” standard in segregation, demonstrates the relationship between changing sentiments, shifts in the regard for others, and changes in law. There is an entire class of examples in which economists’ judgments about efficiency are flawed because they ignore the sentiments of those not directly affected, the sentiments of third parties. These include the efficiency of rape, abortion, dueling and slavery. I consider the examples of slavery, dueling and segregation below.

1. Slavery

In response to criticism from Dworkin, Posner (1980) has offered the defense of efficiency that it probably condemns slavery as inefficient, because a person could, if he chose, be more productive in the sense of producing a greater physical output as a free person than as a slave.¹⁰⁷ This argument is both technically incorrect and misguided.

It is technically incorrect as it ignores those sentiments that must be taken into account in determining efficiency, even if we confine ourselves to the sentiments of the slave and of the owner, and ignore the regard for others. Consider, first, only the transactions between the slave and the owner. Imagine that the status quo position is one of slavery. The efficiency question is, then, whether the WTP of the slave is greater than the WTA of the owner. Even if the slave could be more productive free, and capital markets were perfect, so that the slave can borrow against future earnings, we cannot say whether the WTP of the slave would be greater than the WTA of the owner. The owner may have a taste for owning a slave and may be willing to suffer the financial loss inherent in retaining the slave because the psychological gain is greater than the

¹⁰⁶ An ongoing change in sentiments is happily reflected in Sen’s (1999, pp. 20, 104-107) criticism of values that have led to the phenomenon of “missing women,” women in developing countries whose survival has not been given proper weight.

¹⁰⁷ For example, see Posner (1980, pp. 501-502). Posner notes (1980, p. 1), “For example, if we started with a society where one person owned all the others, soon most of the others would have bought their freedom from that person because their output would be greater as free individuals than as slaves, enabling them to pay more for the right to their labor than that right was worth to the slave owner.”

financial loss. Posner's mistake arises partly from his focus on efficiency in terms of mainly material wealth, but primarily from ignoring the regard for others.¹⁰⁸

The fact is that one cannot maintain that slavery — at least by the 1850s in the United States — was efficient on the basis of available evidence, Professors Fogel and Engerman notwithstanding. Professors Fogel and Engerman¹⁰⁹ maintain that slavery was efficient, but what they show, instead, is that it was economically viable. They answer in the negative the question “If slavery had been eliminated, would the GNP have been greater?” I see no reason to doubt their answer.

But to determine whether slavery was efficient is a different question from the one Fogel and Engerman, as well as Posner, addressed. A different question would have had to be asked and answered: “Would the WTP of those opposed to slavery have been greater than the WTA of slaveholders?”¹¹⁰ To this question no answer has been provided. That slavery might not have been efficient is suggested when we consider the sentiments of others, and the social antipathy to it that was already growing.¹¹¹ One cannot imagine that the practice would have survived the turn of the century, even without the Civil War.

2. Dueling and Economic Efficiency

The social convention of dueling in the antebellum South has been held by Schwartz et al. (1984) to have been an efficient norm. The offered proof, which consists of pointing out elements of efficiency in the practice, cannot, however, be accepted, under either wealth maximization or KHM, because its definition of efficiency does not take into account moral sentiments (what I

¹⁰⁸ Similar criticisms can be made about Posner's discussion of rape. The regard for others is, however, recognized by Calabresi and A. Douglas Melamed (1972, pp. 1089, 1112). They note at 1112, “[I]f Taney is allowed to sell himself into slavery, or to take undue risks of becoming penniless, or to sell a kidney, Marshall may be harmed, simply because he is a sensitive man who is made unhappy by seeing slaves, paupers or persons who die because they sold a kidney” (p. 1112).

¹⁰⁹ See Fogel and Engermann (1974).

¹¹⁰ If the possession of slaves is regarded as a matter of rights in dispute, the WTA of both parties will also play a role, as I showed earlier.

¹¹¹ *Uncle Tom's Cabin* was the greatest fiction success of the nineteenth century. Alfred Kazin, *Introduction to Uncle Tom's Cabin*, vi (Bantam Books ed., 1981). It was not for nothing that President Lincoln greeted Mrs. Stowe as “the little woman who wrote the book that made this great war” (Kazin, p. ix). Kazin also notes that “Mrs. Stowe had brought to her indictment of slavery . . . a moral passion that in the book is the most powerful antagonist of slavery and one that so worked on people's feelings from 1852 to the end of the Civil War that no other single book can be said to have contributed so much to the end of slavery” (Kazin, p. viii).

have called the regard of others (Zerbe, 2001)). The problem that Schwartz et al. does not overcome is that dueling, even in the antebellum South, was a contentious norm. Its efficiency cannot therefore be proved without a closer examination of the regard for others; the sentiments of the general population need to be determined through a detailed evaluation.

The evidence suggests that the sentiments against dueling were considerable. Schwartz et al. (p. 326) note that “one other important feature of the larger social context was that the duel was explicitly made illegal and subjected to severe penalties.” The laws were, in fact, carefully designed to eliminate the practice. This contention was not confined to the antebellum South. In England, for example, there was never a time when private dueling was legal, according to Bothwick.¹¹² From a KHM perspective, what is of interest is why the practice of dueling arose and why it waned.

Trial by combat was a part of the legal system in England only after the time of William the Conqueror (Neilson, 1891). It arose, in large part, in response to widespread perjury, and from reasoning apparently from the elite that it was better to risk one’s body than one’s soul (Neilson). Possibly, in a more Christian period, it was felt that God gave victory to the right, although — somewhat ironically — the Christian church was actually attempting to abolish dueling. As Gibbon (1899, p. 552) noted, “Is it not true that the event both of national wars and of private combat is directed by the judgment of God? And does not Providence award the victory to the juster cause.” From the Crown’s point of view, dueling was narrowly efficient, in that it seems to have brought more money into the treasury (Neilson). In England, probably from the time after the reign of Henry I, there was no battle in civil cases unless the property in dispute was worth at least ten shillings (Neilson). In Scotland, however, which the English considered to be a more primitive country, parties had recourse to “cold iron” even in disputes concerning the most trivial property (Bothwick, 1776). “In a rude age, this method of proceeding was exceedingly natural” (Bothwick, p. 8, note 157).

A change in sentiments played a role in the decline of dueling.¹¹³ The practice was never universal (Neilson). It was not practiced by the Greeks or the Egyptians, nor was it part of the

¹¹² Bothwick (1776, p. 19) notes, “That although, in times of ignorance, our ancestors had recourse to a blind method of trial by duels, yet there never was a period in the annals of Britain, when duels could be lawfully engaged in by private parties.”

¹¹³ A similar experience may be seen in the history of flogging in the British Navy. “Flogging around the fleet disappeared by the mid-1800s, and by 1870 a captain’s right to order flogging was severely

Roman codes or the treatises of their jurists. In Europe, from its earliest days, the influence of the Christian church was directed against trial by combat, and seems to have been in the main directed against it during succeeding centuries (Neilson). Clearly, by the late 18th century the practice was regarded with repugnance (Neilson). Neilson (p. 3) notes that “its roots must be sought in lands inhabited by a people not yet advanced beyond the barbarian stage.” There was a steady process of restriction of trial by battle to the writ and the appeal of felony. By 1219, a rigid line had formed around the duel which it could not pass: “In burgh after burgh it passed away ... in the other courts in which it was competent, the judges more and more found reasons and made them, for disallowing a mode of trial in which they could have little faith, and in which the people at large by no means loved When the century ended, trial by battle was far advanced on the high road to extinction. It had become uncommon before the close of the reign of Henry VI” (Neilson, p. 72).

In the South after the Civil War, the value of honor probably declined. A similar explanation may apply to England and Scotland. Bothwick (p. 8) notes that “Expressions which go for nothing in the year 1776 would not have gone for nothing in the year 1400. In proportion as honesty is become rare, a sense of personal honour is become less delicate.” Thus without taking into account the change in sentiments, Schwartz et al cannot prove that dueling was efficient.

2. *Plessy v. Ferguson*: A Misapplication of the Common Law Tradition and the Difficulty of Determining Efficiency in the Absence of a Uncontentious Norm

The common law tradition of using social norms to create law is not invariably efficient, and it is particularly likely to be inefficient if the norm is contentious. As Blackstone (p. 43f) noted, a norm is an efficient tool in creating law only when the norm is uncontentious. An example is found in the famous case of *Plessy v. Ferguson*.¹¹⁴ *Plessy* bungled the common law tradition in three ways: 1) it adopted a “norm” that lacked sufficient support; 2) it adopted a “norm” when a

restricted. In 1879 it was abolished,” according to Massie (1991).
¹¹⁴ 163 U.S. 537 (1896).

competing norm existed; and 3) it adopted a “norm” that ultimately lost out to a competing norm.¹¹⁵ The *Plessy* court faced a situation where no uncontentious norm existed.

Plessy upheld a Louisiana statute that provided for “separate but equal” accommodations for white and African-American train passengers, and provided for fines and imprisonment of passengers and train employees who refused to comply with the rules.¹¹⁶ Contrary to popular belief, *Plessy* did *not* require that the facilities for whites and African Americans be equal; it held that a racially discriminatory law is constitutional if it is “reasonable” in light of the “established usages, customs, and traditions of the people.”¹¹⁷ Because the statute was consistent with Louisiana’s “social conventions,” the statute was held constitutional.¹¹⁸ Clearly the *Plessy* decision was norm-seeking.

Justice Harlan argued in dissent that the “reasonableness” of the statute in light of Louisiana’s “social conventions” was irrelevant.¹¹⁹ At first glance, this appears to be a rejection of the common law tradition; if so, his dissent would be of little use in determining the efficiency of *Plessy*.¹²⁰ However, Justice Harlan’s opinion makes it clear that it is not Louisiana’s social conventions that are relevant, but those of the United States.¹²¹ Thus, the Fourteenth Amendment renders Louisiana’s policies unconstitutional.¹²² Using the language of KHM, Justice Harlan argued that Louisiana’s custom of segregation should not be considered, because the United States had made a reasonable social judgment that the costs of governmental racial discrimination outweigh any benefits the citizens of the state would receive from it.¹²³ Just as a thief lacks standing to argue that his WTP for stolen goods is higher than his victim’s WTA,

¹¹⁵ *Id.*

¹¹⁶ See *id.* at 541, 550-551.

¹¹⁷ See *id.* at 550-551.

¹¹⁸ See *id.* Justice Harlan points out, in dissent, that racial *segregation* was not Louisiana’s social convention in any event, because it prevented an African-American servant from waiting on a white patron during the ride, something that Louisiana’s social conventions not only allowed but demanded of African Americans. See *id.* at 553. The point is not that a norm of servitude is morally superior to a norm of segregation, but merely that the alleged norm of segregation was not even historically accurate.

¹¹⁹ See *id.* at 550-551, 557.

¹²⁰ *Id.*

¹²¹ See *id.* at 554. Justice Harlan notes, “[T]he Constitution of the United States does not, I think, permit any public authority to know the race of those entitled to be protected in the enjoyment of [constitutional] rights.” See *id.* at 554. Saying that a public authority may not “know” a certain fact when making a decision is an apt description of what it means to deny economic standing.

¹²² See *id.*

¹²³ See *id.* at 555.

Louisiana lacked standing to argue that its statute is efficient because of its consistency with Louisiana's norms.

The majority in *Plessy* at least partially recognized the legitimacy of Justice Harlan's argument, in that it attempted to formulate a norm that justifies Louisiana's statute but that is consistent with the spirit of the Fourteenth Amendment.¹²⁴ The majority argued that racial integration is only appropriate when it is "voluntary" and a product of "a mutual appreciation of each other's merits."¹²⁵ This argument was incoherent, however, because Louisiana's statute provided for fines and imprisonment if a white and an African-American passenger decided to sit together because they had a "mutual appreciation of each other's merits."¹²⁶ The majority's incoherence was inevitable, because there *was* no norm that justified Louisiana's statute that was consistent with the Fourteenth Amendment.¹²⁷

Plessy improperly applied a norm that lacked the uncontentious quality required by Blackstone. At the time of *Plessy*, there were competing norms of racial integration and racial segregation, and neither norm was sufficiently "uncontentious" to guarantee efficiency.¹²⁸

Furthermore, the norm *Plessy* attempted to establish did not become uncontentious over time.¹²⁹ In fact, support for *Plessy*'s norm evaporated, leading the Supreme Court to back away from its holding.¹³⁰ In *Ex Rel Gaines v. Canada*, the Supreme Court held that it was unconstitutional for Missouri to provide for a legal education for African Americans by subsidizing their tuition to attend law school in an adjacent state.¹³¹ In *Gaines*, the majority demanded that the privilege of education be extended to all races on an "equal" basis, while the dissent insisted that the question was merely whether the state had made a "reasonable" effort to provide "specialized education" to African Americans.¹³² The dissent's approach was probably

¹²⁴ See *id.* at 550-551. For a discussion of the thief example, see Zerbe (2001a) and Cooter and Ulen (1997).

¹²⁵ See *Plessy*, at 550-551.

¹²⁶ See *id.*

¹²⁷ See *id.* at 551, 557.

¹²⁸ At a minimum, Harlan's eloquent dissent provides an example of one competing norm. See *id.* at 552-564.

¹²⁹ *Id.*

¹³⁰ *Id.* See *McLaurin v. Oklahoma State Regents for Higher Education*, 339 U.S. 637 (1950); *Sweatt*, 339 U.S. 629 (1950); *Gaines*, 305 U.S. 337 (1938).

¹³¹ See *Gaines*, 305 U.S. at 342, 349-352.

¹³² See *id.*, at 349, 353.

more consistent with *Plessy*'s "reasonableness" standard than was the majority's approach, but after *Gaines* "reasonableness" was not enough.¹³³

Sweatt v. Painter involved Texas' attempt to maintain the all-white status of the University of Texas Law School by creating a smaller, adjacent law school for African Americans, with many of the same faculty and textbooks.¹³⁴ The majority of the Supreme Court held that this "separate" school was not "equal."¹³⁵ While the *Sweatt* court could have relied on the tangible inferiority of the African-American law school, it instead focused on the "intangible" factors such as "reputation of the faculty, experience of the administration, position and influence of the alumni, standing in the community, traditions and prestige."¹³⁶ While *Sweatt* recognized the theoretical possibility of a separate law school that was equal to the white one, it is hard to imagine how any non-white school — which in Texas would necessarily be a *new* law school — could have alumni of equal "influence," or comparable community standing and "prestige."¹³⁷

The court in *McLaurin v. Oklahoma State Regents for Higher Education* held that an integrated graduate school of education had violated the Fourteenth Amendment, even though it had admitted an African American into its department, because it forced him to sit in a designated row in the classrooms, and in a designated table in the cafeteria and in the library.¹³⁸ McLaurin's education would have been as "equal" to that received by the white students as any separate education could have been, considering that he would have heard the same lectures from the same professors and studied the same books in the same library.¹³⁹ However, the court recognized that interaction with other students is an essential aspect of education, and that McLaurin would be unfairly (and unconstitutionally) denied this interaction.¹⁴⁰ Any theoretical possibility of a segregated school's passing constitutional muster that was left open by *Sweatt* was closed by *McLaurin*.¹⁴¹ If interaction with other students is an essential part of education, such that denying an equal opportunity to interact means denying an equal education, then

¹³³ Compare *Plessy*, 163 U.S. at 550-551, with *Gaines*, 305 U.S. at 349, 353.

¹³⁴ See *Sweatt*, 339 U.S. at 632-636.

¹³⁵ See *id.*

¹³⁶ See *id.* at 633-634.

¹³⁷ See *id.*

¹³⁸ See *McLaurin*, 339 U.S. at 638-642.

¹³⁹ See *id.*

¹⁴⁰ See *id.* at 640-641.

¹⁴¹ See *McLaurin*, 339 U.S. 637; *Sweatt*, 339 U.S. 629.

segregation is inherently unconstitutional, because the effect (indeed, the *purpose*) of segregation is to prevent interaction between students of different races. When we consider *Sweatt*'s recognition that the "position and influence" of a school's alumni is an essential element of its quality, it becomes clear that segregated schools disadvantaged African-American students.¹⁴² After *McLaurin*, there was only a short conceptual step to *Brown v. The Board of Education*.¹⁴³

Brown formally declared that segregated schools are inherently unequal.¹⁴⁴ *Brown* justified its departure from *Plessy* on the grounds that social conditions had changed.¹⁴⁵ First, *Brown* noted that public education was far more important in 1954 than it had been at the time of the Fourteenth Amendment's passage (1868) or even at the time of *Plessy* (1896).¹⁴⁶ Compulsory education, which dramatically increased the importance of high-quality public education, was not adopted by every state until 1918.¹⁴⁷ Second, *Brown* cites a series of psychological studies arguing that segregation harmed the self-esteem of African-American students.¹⁴⁸ The validity of those studies has been vigorously attacked,¹⁴⁹ but what is more important for my purpose is the implicit recognition that society's willingness to tolerate attacks on the self-esteem of African Americans had changed: in other words, the regard for others had changed. As the regard for others shifted, *Plessy*, which had probably never been efficient, became ever more palpably inefficient. The *Plessy* court responded to the argument that segregation was intended to degrade African Americans with a callous statement that it was only insulting "if the colored race chooses that construction" — implicitly stating, "That's your problem: deal with it."¹⁵⁰ *Brown* recognized that the regard for others had shifted, such that the possibility that African-American students' self-esteem suffered from segregation was counted as a loss both the students and to others, implying a right to not be exposed to the loss.

¹⁴² See *Sweatt*, 339 U.S. at 634.

¹⁴³ *Brown v. The Board of Education of Topeka*, 347 U.S. 483 (1954).

¹⁴⁴ *Id.* at 493.

¹⁴⁵ See *id.* at 492-493.

¹⁴⁶ See *id.*

¹⁴⁷ See *id.* at 490.

¹⁴⁸ See *id.* at 494-495.

¹⁴⁹ Indeed, many of the authors of these studies retracted their findings.

¹⁵⁰ See *id.* Justice Harlan, in contrast, recognized that "everyone knows" that the purpose of the Louisiana statute was to degrade African Americans. See *id.* at 556-557.

C. A CHANGE IN TECHNOLOGY: WITH RAPID CHANGE, CUSTOM AND INTELLECTUAL KNOWLEDGE MAY BE INSUFFICIENT TO DETERMINE EFFICIENCY

The example is a Wisconsin case involving restriction to sunlight. This example shows how difficult it can be for courts to determine what is efficient under changing conditions.¹⁵¹

Sunlight and the Law of Nuisance

Prah v. Maretti involved a dispute about whether the defendant committed a nuisance when he obstructed the plaintiff's access to sunlight.¹⁵² The plaintiff, Prah, had built a system using solar collectors to provide his house with heat and hot water.¹⁵³ The defendant, Maretti, then purchased property adjacent to Prah's and began to build a home there.¹⁵⁴ Prah argued that Maretti's construction would prevent him from receiving enough sunlight to get adequate use from his solar collectors, and that Maretti committed a nuisance by interfering with his access to sunlight. Maretti argued that, under Wisconsin law, one could not commit a nuisance simply by obstructing his neighbor's access to sunlight.¹⁵⁵ That is, in essence, Maretti argued that Wisconsin denied standing to plaintiffs seeking access to sunlight.¹⁵⁶ The majority of the Wisconsin Supreme Court recognized that — in the past — courts had consistently denied standing to such plaintiffs, but decided to overrule that line of cases, and granted standing to such plaintiffs.¹⁵⁷

In an era of rapid social change it is also possible for judges to *overreact* to social change, and to change the law even though the new social values do not justify a change in the law. The

¹⁵¹ Another example may be found (Zerbe, 2001, pp.69f) in Richard Posner's decision in *Lorenzen v. Employees Retirement Plan of the Sperry & Hutchinson Co.*, 699 F. Supp. 1367 (E.D. Wis. 1988), *rev'd* 896 F.2d 228 (7th Cir. 1990).

¹⁵² See *Prah v. Maretti*, 321 N.W.2d 182, 184 (Wis. 1982).

¹⁵³ See *id.*

¹⁵⁴ See *id.* at 185 (noting that Maretti had received permission to build his home from both the subdivision and the city).

¹⁵⁵ See *id.* at 188-189. Before *Prah*, the only way to acquire a protectable interest in sunlight under the common law was to convince one's neighbor to give him an express easement for sunlight. See *id.* An easement is essentially a contract between two landowners, which either grants one person the right to use another person's land in some limited way, or which prevents a person from using his own land in a particular way. See *id.* In this particular case, Prah and Maretti attempted to negotiate an agreement but were unable to reach a compromise. See *id.* at 185.

¹⁵⁶ See *id.* at 184.

¹⁵⁷ See *id.* at 189.

judges may *overestimate* the extent or importance of the social change. *Prah* is an example of a case in which the majority appears to have overreacted to a social change.¹⁵⁸

Under the law of nuisance, a person cannot *unreasonably* interfere with another person's ability to enjoy his or her property.¹⁵⁹ In a typical nuisance action, the defendant is using his or her land in a way that is inconvenient or annoying to the plaintiff.¹⁶⁰ The plaintiff must first show that he or she is not a "hypersensitive" landowner.¹⁶¹ If the defendant's conduct is only disruptive to the plaintiff because the plaintiff is unusually sensitive or vulnerable, the defendant's conduct is not a nuisance, even if the plaintiff is suffering extreme economic losses as a result.¹⁶²

If a court concludes that the plaintiff is not hypersensitive, the court then goes on to compare the utility of the defendant's conduct with the gravity of the harm to the plaintiff.¹⁶³ Under the Restatement (Second) of Torts § 827, the factors to be considered in measuring the gravity of the plaintiff's harm include: (a) the extent of the harm involved; (b) the character of the harm involved;¹⁶⁴ (c) the social value that the law attaches to the type of use or enjoyment invaded; (d) the suitability of the particular use or enjoyment invaded to the character of the locality; and (e) the burden on the person harmed of avoiding the harm. The factors to be considered in measuring the utility of the defendant's conduct include (a) the social value that the law attaches to the primary purpose of the conduct; (b) the suitability of the conduct to the character of the locality; and (c) the impracticability of preventing or avoiding the invasion (Restatement (Second) of Torts § 828).

¹⁵⁸ See *id.* at 194 (dissenting opinion).

¹⁵⁹ See *id.* at 187.

¹⁶⁰ See *id.*

¹⁶¹ See *id.* at 197 (dissenting opinion).

¹⁶² See *id.*

¹⁶³ See *id.* at 187.

¹⁶⁴ By "character of the harm" the Restatement means that nuisances that cause physical damage to a structure on real property are in general more serious than personal discomfort or annoyance. The Restatement's justification for treating physical damage as more important than those that cause personal discomfort is that the former is much easier to prove than the latter. If the Restatement is simply making a prediction that plaintiffs will be successful more often when they produce evidence of physical damage to their property, because physical damage is easier to prove than discomfort, this distinction is sensible. If the Restatement is making a prescription that preventing or reimbursing people for personal discomfort be treated as less important than preventing or reimbursing physical damage, even when the economic injury (WTA or WTP) is the same, that distinction is not sensible.

The Restatement's approach to nuisance law is consistent with KHM's approach to benefit-cost analysis. To determine the plaintiff's WTA or WTP, we need to know both the seriousness of the harm caused by the defendant and the plaintiff's opportunity cost. Similarly, to determine the defendant's WTA or WTP, we need to know both the value of his conduct to him and his opportunity cost. The Restatement asks us to consider both the value of the defendant's conduct to the two parties and their opportunity costs, allowing us to determine their WTP and WTA.

Furthermore, the Restatement's consideration of whether the plaintiff's use or the defendant's use is more consistent with the neighborhood helps determine the opportunity costs of each, especially when the best way to avoid the injury is for one of the parties to move. It is probably more efficient to make a person change his or her lifestyle to fit the needs of the neighborhood (either by moving or by adopting some measure that reduces the harm of the invasion) than to make the whole neighborhood change to fit the needs of one party.

The Restatement also incorporates moral sentiments by considering the social value that the law attaches to the plaintiff's use and the defendant's use. If society attaches "value" to ensuring that the plaintiff wins and the defendant loses, then the regard for others favors giving the right to the plaintiff. Similarly, if society is willing to pay or willing to accept payment to ensure that the defendant wins, the regard for others is in favor of the defendant.

If a nuisance is proved, the plaintiff is typically entitled to damages for the past interference and an injunction against future interference.¹⁶⁵ Injunctions are available to plaintiffs who have suffered irreparable injuries — that is, injuries for which merely damages would be inadequate.¹⁶⁶ Because the law views each parcel of land as unique, an injury to land is often deemed to be irreparable.¹⁶⁷

Even if the plaintiff cannot convince the court that the defendant's use is a nuisance, the plaintiff can prevent the harm by convincing the defendant to grant a restrictive easement or a covenant.¹⁶⁸ On the other hand, if something is held to be a nuisance, the defendant can purchase

Whether an injury has been proved is a separate issue from the weight that should be given to an injury once it has been proved.

¹⁶⁵ See *id.* at 184.

¹⁶⁶ See *Stokes Cty. Soil Conservation Dist. v. Shelton*, 67 N.C. App. 728 (1984).

¹⁶⁷ See *United Church of the Med. Ctr. v. Medical Ctr. Comm'n*, 689 F.2d 693, 701 (7th Cir. 1982).

¹⁶⁸ See *Prah*, 321 N.W.2d at 188. Easements or covenants are special types of agreements. They are essentially contracts in which a party either agrees to allow another person to use his property, or agrees

from the plaintiff the right to continue committing the nuisance. Therefore, the consequence of a court declaring that something is not a nuisance is that the invasion will continue unless the plaintiff's WTP is higher than the defendant's WTA, after transactions costs. On the other hand, the consequence of a court declaring that something is a nuisance is that the invasion will not continue unless the defendant's WTP is higher than the plaintiff's WTA, after transactions costs. Because the WTA is higher than the WTP for normal goods, declaring something to be a nuisance increases the odds that the activity will be stopped, but it does not guarantee it.¹⁶⁹

Interestingly enough, historically, plaintiffs seeking access to sunlight had previously been denied standing because the law of nuisance recognized three broad social policies that were widely accepted in the nineteenth and early twentieth centuries that, if true, would justify the denial of standing.¹⁷⁰

First, there was a widespread belief that a landowner should be able to put his land to any use he wished, so long as he did not cause physical damage to a neighbor.¹⁷¹ If a plaintiff could stop the defendant from developing his property simply to ensure the plaintiff's access to sunlight, society would feel that the defendant was being treated unfairly, and this sense of unfairness would cause society to experience a loss due to the regard for others.

Second, sunlight was valued only for its aesthetic qualities to its owner, and it was thought that the owner could acquire equivalent illumination through artificial devices.¹⁷² In other words, it was believed that the plaintiff seeking sunlight had a low WTA and WTP, because sunlight was of relatively little value and the opportunity costs of purchasing artificial light was relatively low.

Third, society had a significant interest in encouraging property development.¹⁷³ The United States was in the middle of a growth period that was almost universally viewed as necessary to its future. That is, economic growth or development as defined by market goods

not to use his own property in a certain manner. The law of property sometimes creates an easement or covenant even when there is no express agreement (such as an easement by prescription).

¹⁶⁹ The finding of a nuisance also has a distributive effect, because the plaintiff's wealth is increased at the expense of the defendant. The plaintiff's wealth will increase because either a harmful activity will be prevented, or the plaintiff will receive a sum of money that is at least as valuable to him as preventing the activity.

¹⁷⁰ See *Prah*, at 189-190.

¹⁷¹ See *id.*

¹⁷² See *id.*

¹⁷³ See *id.*

was highly valued relative to non-market amenities. It was believed that American society experienced a significant gain whenever U.S. land was developed, and that judges would inflict a loss on society if they recognized a right to sunlight and allowed plaintiffs to prevent development. In other words, the United States had a direct interest in encouraging development, and experienced a gain when development was allowed.

The *Prah* court concluded that a series of social changes had occurred in the late twentieth century that undermined the three social goals outlined above.¹⁷⁴ First, sunlight had become something more than just an aesthetic luxury; it had become an energy source.¹⁷⁵ Therefore, the value of sunlight to the plaintiff is likely to be higher than it was before. Furthermore, the opportunity cost of losing sunlight is higher, because one cannot generate solar energy artificially. Artificial devices can provide illumination, but they cannot be used to generate electrical energy.

Second, the value of non-market amenities had grown relative to traditional market growth since the nineteenth century. Today, society is less willing to encourage traditional market growth at the expense of environmental and other amenities.¹⁷⁶

Third, the United States is rapidly depleting its supply of fossil fuels, and significant public policy has been aimed at experimenting with and developing alternative energy sources.¹⁷⁷ Therefore, allowing the plaintiff to develop solar energy would likely result in a *direct* benefit to American society, because it lessens the burden on fossil fuels.

Fourth, American attitudes toward property owners have changed, and few Americans still believe that a landowners should have a completely unrestricted right to develop their property.¹⁷⁸ Today, Americans regard a relatively large degree of regulation of land use as reasonable, even when one has not physically injured his neighbor's property. Therefore, the regard for others is less likely to favor allowing a defendant to use his property in a way that obstructs sunlight, even if the defendant is not causing a physical harm to the plaintiff's property.

In light of those four changes, the court concluded that it was no longer reasonable to *assume* that it was in America's best interests to deny standing to plaintiffs seeking access to

¹⁷⁴ *Id.*

¹⁷⁵ *Id.*

¹⁷⁶ *Id.*

¹⁷⁷ *Id.*

¹⁷⁸ *See id.*

sunlight.¹⁷⁹ Therefore, it is efficient to grant standing to people seeking access, so that a court can determine, on a case-by-case basis, whether a particular plaintiff's need for sunlight is greater than a particular defendant's need for development. The Wisconsin Supreme Court remanded, directing the trial court to consider the factors specified in the Restatement to determine whether Maretti's construction actually constitutes a nuisance.¹⁸⁰

Judge Callow argued in dissent that the court should continue to deny standing to plaintiffs seeking access to sunlight.¹⁸¹ He made three arguments to support his conclusion. First, he argued that the state legislature is in a better position than the courts to determine whether there has been a change in the regard for others.¹⁸² Therefore, the courts should continue to deny standing to plaintiffs seeking access to sunlight until the legislature grants this right to plaintiffs. In fact, he noted that the legislature had actually drafted a statute that governed one's right to sunlight, and argued that the court was wrong to ignore that statute.¹⁸³ Under the statute, one who builds a solar collector can prevent a neighbor from blocking his access to sunlight only if the plaintiff received a solar access permit from the state before the defendant received a permit to build his house from the local subdivision and the city.¹⁸⁴ In this case, Prah apparently had never received a permit from Wisconsin, and Prah did not notify Maretti that he had built a solar plant until after Maretti had received a building permit from the local subdivision and the city.¹⁸⁵ Therefore, under the recently adopted Wisconsin statute, Prah had no right to prevent Maretti's construction.¹⁸⁶

Callow's argument that the judiciary should let the legislature decide what is in the public interest and what the regard for others favors is a common argument, but it is not self-evidently correct. In this case, however, the legislature actually had acted, and it had drafted a statute striking a balance between the interests of solar power users and the interests of people who wished to develop their property. The legislature's "first in time" approach to the issue of

¹⁷⁹ *Id.*

¹⁸⁰ *See id.* at 192.

¹⁸¹ *See id.* at 193-199.

¹⁸² *See id.* at 195.

¹⁸³ *See id.* at 195-196.

¹⁸⁴ *See id.*

¹⁸⁵ *See id.*

¹⁸⁶ *See id.*

conflicts between solar power users and other landowners is a reasonable one, and the majority probably should have at least considered it.¹⁸⁷

Second, Callow argued, in essence, that courts should only recognize the regard for others in an action alleging a public nuisance, not a private nuisance.¹⁸⁸ Callow's argument is not a persuasive one, at least under KHM analysis. The regard for others would probably be *more* strongly opposed to a defendant who committed a public nuisance than it is opposed to a defendant who committed a private nuisance, but there is no reason to ignore the regard for others in private nuisance actions. If the regard for others is ignored in private nuisance actions, courts would frequently reach inefficient decisions, under KHM's definition of efficiency; to ignore a class of sentiments that represents a WTP for a result will lead to inefficiency where the WTP is of sufficient magnitude to reach a different conclusion. Such a conclusion would then be not only inefficient but unjust.

Third, Callow argued that even if solar power is of greater value today than it was in the nineteenth century, and even if the regard for others favors plaintiffs in Prah's position, it is *still* true that Prah is a *hypersensitive* plaintiff, and thus it is still efficient to deny standing to Prah.¹⁸⁹ Callow notes that whether a plaintiff is hypersensitive is largely a question of relative numbers.¹⁹⁰ A hypersensitive plaintiff is a plaintiff who is bothered by something that most people would not find bothersome.¹⁹¹ It may be true that Prah is engaging in a socially useful activity by experimenting in solar energy, but the fact remains that most people would not have been bothered by Maretti's construction.¹⁹² Judge Callow analogized to the history of the law's treatment of horses and cars.¹⁹³ When the car was first invented, it was frequently held to be a

¹⁸⁷ In addition, the legislature's rule might have reduced the transactions costs of both those seeking access to sunlight and those seeking the right to build a home on their property. Whether a person holds a solar access permit is publicly available information. Under the legislature's approach, it would be relatively easy for solar power users to express their need for sunlight, by requesting a permit. Similarly, it would be relatively easy for people who wish to build a home to find out whether any of their neighbors had a permit. By thwarting the legislature's approach, the court makes it more difficult for people like Maretti to find out whether any of their neighbors has a particularly intense need for sunlight.

¹⁸⁸ See *Prah* at 194-195.

¹⁸⁹ See *id.* at 196-197.

¹⁹⁰ See *id.* at 195.

¹⁹¹ See *id.*

¹⁹² See *id.*

¹⁹³ See *id.*

nuisance to horses.¹⁹⁴ Many more people owned horses than owned cars, and thus it made sense to require car owners to restructure their lives to reduce the impact on horses, rather than requiring horse owners to restructure their lives to suit car owners.¹⁹⁵ Later, when cars became commonplace, the *horse* was held to be a nuisance.¹⁹⁶ Callow suggests that solar energy is still in such an early stage of development that solar energy users like Prah are hypersensitive, while home-builders like Maretti are behaving reasonably.¹⁹⁷

Callow's third argument is highly persuasive. The majority is almost certainly correct in arguing that society's attitude toward the value of sunlight has changed,¹⁹⁸ but Callow is almost certainly correct in responding that society has not changed enough to justify a new legal rule.¹⁹⁹ Despite the social changes that the majority discusses, the fact remains that the vast majority of homeowners in Wisconsin would not be bothered by Maretti's construction, because the vast majority of homeowners in Wisconsin do not rely on solar power for heat and hot water. Therefore, solar power users like Prah are hypersensitive. While society has changed, society has not changed *enough* to make solar energy use more widespread. Just as the car eventually succeeded the horse, it may be that solar energy will eventually become so valuable that one who desires access to sunlight would not be considered hypersensitive. However, it seems unlikely that Wisconsin had reached that point in 1980, and thus the majority's decision was premature.²⁰⁰

XI. CONCLUSION

The argument presented here suggests that the considerable and long-standing debate about both the predictive and normative roles of economic efficiency on the one hand and justice on the other is misplaced. Economic efficiency, properly presented as KHM, is justice, where justice is seen as legitimate expectations arising from rights and norms. Thus, the article suggests a reason for the efficiency of common law rooted in the search for justice.²⁰¹ Efficiency and justice

¹⁹⁴ See *id.*

¹⁹⁵ See *id.*

¹⁹⁶ See *id.*

¹⁹⁷ See *id.*

¹⁹⁸ See *id.* at 188-189.

¹⁹⁹ See *id.* at 197.

²⁰⁰ *Id.*

²⁰¹ This view will allow judges and other scholars who wish to rely on economic efficiency to understand that they are also relying on principles of justice. It will allow economists to realize more fully the inherently normative nature of efficiency, and that efficiency needs not

correspond and judges seek justice as a consequence of a social norm. For both economists and judges, if their arguments seem incorrect when reformulated with either justice or efficiency language, they were properly originally formulated incorrectly.

Judges find justice and efficiency in custom and intellectual knowledge. As technology, sentiments and knowledge change the law can become incomplete and/or unfit and thus inefficient. Judges seek to improve the efficiency of the law by incorporating custom and intellectual knowledge. As conditions change rapidly, however, these may be in short supply and the common law will be less efficient.

The thesis is developed through several examples. One shows efficient judge-made changes in antitrust law through the incorporation of intellectual knowledge. The examples of slavery and dueling show that KHM is a better approach to understanding change than KH. The examples of access to sunlight and racial equality show how difficult it can be to determine either efficiency or justice when there is neither sufficient custom nor knowledge. As Simpson notes, justice and efficiency are a matter of recourse to the conscience of the community (Simpson, 1990).²⁰² One way to look at the evolution of common law is to note that common law tends toward fairness and justice; efficiency is a by-product.²⁰³

be seen as attached to selfish behavior; moral sentiments are also a consistent part of efficiency. Judges and others that wish to use the language of justice can reformulate their arguments to relate to economic efficiency.

²⁰² Simpson's (1990) discussion of the Mignonette shipwreck gives us an example where the court would have preferred the destruction of four lives through starvation to the destruction of one life through cannibalism. This is clearly "inefficient" in the sense of the destruction of greater human capital, but it is not necessarily inefficient in a KHM sense. Whether this outcome is inefficient in a KHM sense depends on where rights and sentiments lie. In other words, if the regard for others finds cannibalism sufficiently appalling, it might be more efficient to sacrifice four lives to starvation than to sacrifice one life to cannibalism.

²⁰³ See Easterling (1992) for an analysis in which efficiency contributes to fairness.

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