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Legislative Deals and Statutory Bequests

Daniel A. Farber*

Until recently, the subject of statutory interpretation was a forgotten backwater of legal scholarship.¹ Today, however, it has become an exciting and rapidly growing body of scholarship.² Much of the credit goes to three former law professors from the University of Chicago: Antonin Scalia, Richard Posner, and Frank Easterbrook. Their innovative writings have sparked intense scholarly debate about subjects such as the legitimacy of legislative history and the role of precedent in statutory interpretation. In debating these issues, scholars have brought to bear an impressive variety of intellectual tools, including the theory of public choice and philosophical theories of language.

Oddly enough, however, scholars of statutory interpretation haven’t given much attention to the interpretation of other legal instruments like contracts, wills, and deeds. Some writers assume that the same method of interpretation should apply to all texts, or at least to all legal texts. These writers sometimes refer to private law in the course of discussions of public law interpretation.³ For example, Judge Robert Bork recently attacked the Supreme Court for using methods of constitutional

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² This scholarship, along with most of the leading cases, is brought together in chapter seven of W. Eskridge & P. Frickey, Cases and Materials on Legislation: Statutes and the Creation of Public Policy (1988). Rather than burden this Essay with heavy footnoting, I would simply refer the reader in search of further enlightenment to the Eskridge and Frickey book. Readers specifically interested in economic models of interpretation should see D. Farber & P. Frickey, Law and Public Choice: A Critical Introduction ch. 4 (1991). Because of the availability of the latter book, I will forego the pleasure of pepperling the Essay with citations to my own previous articles.

³ I assume that most readers have a general idea of what I mean by referring to public and private law. Making this distinction at all precise turns out to be surprisingly difficult. See Farber & Frickey, In the Shadow of the
interpretation that would be absurd if applied to a will. He asks the reader to consider a will that leaves the bulk of the estate to the testator's nephew, with some specific charitable bequests. The judge then gives the whole estate to the judge's own favorite charities, in order to effectuate the testator's general charitable impulses. "No one would think for a moment that the judge was interpreting," Bork says, "[y]et that is what the Supreme Court has often done with the Constitution."4

Another effort to connect public and private law is Frank Easterbrook's discussion of statutes as "deals" that the courts ought to enforce like contracts.5 Unfortunately, he assumes that it is clear how contracts of this kind would (or should) be enforced. Like Bork, he takes the private law end of the analogy for granted, without much thought about the functional resemblances and differences between statutes and contracts.

Apart from these relatively offhand references, discussions of interpretation in public law rarely refer to such documents as wills or contracts. One reason is undoubtedly scholarly specialization. Few constitutional law or legislation scholars teach courses like property or contracts; of those few, most probably regard these courses as pedagogical chores rather than potential sources of inspiration. Because private law is not a subject of much interest to most public law scholars, there has been little cross-fertilization.

This Essay is a tentative effort to think about interpretation in public and private law in a somewhat more systematic way. My plan of attack is to examine interpretation problems in some private law settings and then identify public law analogies. I will limit myself to the simplest kind of interpretation

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4. For Bork aficionados, here is the full quotation:
   The Constitution is law. Like all law it is expressed in language. Language has meaning. Judges who depart from any plausible meaning of the language are not interpreting, they are legislating. Imagine that a judge reads a will that leaves the bulk of the deceased's estate to his nephew but makes specific bequests to a number of charities. If the judge then says that the will discloses a generalized concern for charity and so the nephew's share will go to other charities favored by the judge, nobody would think for a moment that the judge was interpreting. Yet that is what the Supreme Court has often done with the Constitution.

problem: that in which the drafters had a particular situation in mind and adopted language addressing it, so that the interpretation problem is caused only by an ambiguous or vague text.

This limitation leaves out of consideration a host of more complex problems that arise when the parties: (a) had an understanding but failed to incorporate it into the text; (b) considered a problem but failed to agree; (c) did not foresee changed circumstances; or (d) simply failed to consider a possible situation. I have suggested elsewhere that the private law solutions to some of these problems — for example, the treatment of trade usage in the Uniform Commercial Code and the use of *cui pres* to deal with changed circumstances in trusts — do have some useful implications for public law. For today, however, I will stick to the simplest situation, in which interpretation can be understood simply as an effort to find the intended meaning of the text.

I am also going to glide past an important normative question. Private law is largely dedicated to facilitating private ordering, so that people can enter into beneficial transactions. Thus, the law of wills is primarily designed to provide reliable mechanisms for transferring property, and contract law does the same for market exchanges. Depending on what we think of legislators, we might or might not want to design interpretative rules that will further their purposes. Jon Macey has argued, for example, that many statutes are the nefarious product of special interest politics, which statutory interpretation should try to frustrate rather than promote. The attractiveness of his thesis depends largely on the accuracy of this view of legislatures, a subject I have discussed elsewhere but will not pursue here. For quite other reasons, William Eskridge has argued that courts should apply the public values of their own


9. See D. Farber & P. Frickey, supra note 2, ch. 1.
time in interpreting statutes,\textsuperscript{10} and this argument I also set aside for the present.

Instead, I will adopt the analytic tack common in analyses of private law issues, and use economics to determine what legal rules best further the interests of the transactors. I do not purport to offer anything like a complete analysis of either my private law analogies or of the legislative process. This is an avowedly heuristic effort to identify some useful analogies, not an effort at rigorous economic analysis.

I consider four models in this Essay, two involving contracts and two for wills.\textsuperscript{11} In connection with these models, I will consider three currently controversial issues: whether courts should consider extrinsic evidence (legislative history); whether agency interpretations are entitled to deference; and whether stare decisis should apply in statutory cases.\textsuperscript{12} These are complex issues in their own right, but I believe that the private law analogies shed some additional light on these current debates in public law.

The concluding section of the Essay discusses how this sort of analysis might be developed further. The private law models are quite crude and could be improved in some obvious ways. The kind of economic analysis used here may fit some kinds of statutes better than others. Where the analysis does work, different private law models will fit different statutes. We may need several approaches to statutory interpretation, depending on the kind of statute involved.

Apart from the specifics of the models and their applications, this Essay suggests that analysis of statutory interpretation has been both too specific and too general. On the one hand, it has been too specific by focusing almost exclusively on statutes and failing to consider possible analogies to other kinds of legal transactions. On the other hand, it has been too inattentive to the distinctions between different types of statutes.


\textsuperscript{11} Lest the mathophobic be frightened away by the reference to models, I should add that I don’t mean “models” in the sense of differential equations or complicated graphs, I mean something closer to “models” in the sense of “cheap plastic imitations of real objects.”

\textsuperscript{12} For recent and more systematic treatment of these issues, the reader should consult Zeppos, Legislative History and the Interpretation of Statutes: Toward a Fact-Finding Model of Statutory Interpretation, 76 VA. L. REV. 1295, 1398-1335 (1990); Sunstein, Interpreting Statutes in the Regulatory State, 103 HARV. L. REV. 403, 444-46 (1989) (discussing literature on Chevron); Eskridge, Overruling Statutory Precedents, 76 GEO. L.J. 1361, 1363-84 (1988).
that might suggest the use of different interpretative techniques.

I hope that this Essay will advance scholarly efforts to analyze legislation issues. In addition, the models presented here have at least some pedagogic use, since they invoke more easily understood private law analogues to public law problems. Finally, their very crudeness may inspire others to a more rigorous economic analysis of private law interpretation.

I. TESTAMENTARY MODELS FOR STATUTORY INTERPRETATION

The first two models involve seemingly simple testamentary goals. The most important fact about testators is, of course, that they are dead when the will goes into effect.\textsuperscript{13} The testamentary analogy is most appropriate when a statute's drafters are, as a practical matter, "out of the loop" once the statute is passed. To the extent they can readily amend a statute or influence its interpretation (for instance, by using the appropriations process to pressure an administrative agency), the testamentary analogy is potentially misleading. But some statutes, at least, seem to be one-shot efforts with little opportunity for later intervention.

A. MODEL 1: "THE CASE OF THE PARTITIONING PARENT"

Suppose that Ralph Rawls (a cousin of the Harvard philosopher) wants to allocate property between his two adult children, Alan and Betty. It is important to Ralph that the two receive equal shares of the property. Implausibly, we might assume that he has read his cousin's egalitarian philosophy.\textsuperscript{14} More plausibly, he may want both his children and the outside world to perceive him as making a fair division of the property. Or perhaps he doesn't care about his ungrateful children ("they never write!") but feels a religious duty to give them equal shares of the estate. The important thing is that he is concerned with equalizing the amount of their bequests, not with equalizing their ultimate welfare. (The importance of this distinction will become clear when we discuss Model 2.)

On its face, arranging an equal division of property seems straightforward, but for our purposes it is important that the

\textsuperscript{13} Even the most zealous law review editor will not, I suppose, require citation of authority in support of this assertion.

\textsuperscript{14} J. RAWLS, A THEORY OF JUSTICE (1971).
testator face some kind of uncertainty. Let's assume that the estate will contain a large amount of cash as well as a valuable collection of paintings, and that Ralph wants the paintings to stay in the family. He is confident that Alan would keep the paintings, but some additional cash will be necessary to equalize the bequests. Just for the sake of specificity, assume that Ralph has $500,000 in cash and guesses that the paintings are worth about $300,000. He might leave the paintings plus $100,000 to Alan, giving the remaining cash to Betty. He runs the risk, however, of being wrong about the value of the paintings, making the bequests unequal. He can reduce the uncertainty by hiring an expert to appraise the paintings (and he can reduce it even more by hiring more experts). Ralph's difficulty is functionally equivalent to a drafting problem. He has a choice: he can either spend more money on expert assistance and obtain greater certainty about achieving his goals, or he can save the money but take a greater risk.

For a quantitative analysis of Ralph's problem, we would need more information. We would need to know how much appraisers cost, and the degree of certainty associated with their reports. We would also need to know just how much Ralph cares about equalizing the bequests. (For example, how much would he be willing to pay to ensure that the two bequests have values differing by no more than $5,000?) We could then easily determine the optimum amount for Ralph to spend on appraisals. Essentially, he should pay for appraisals until their marginal information value to him is just equal to their marginal cost.

For present purposes, the important point is more basic. From Ralph's perspective, mistakes might go in either of two directions: Either child could mistakenly get a larger bequest than the other. Any deviation from Ralph's preferred outcome (equal bequests) is undesirable from his perspective. Hence, the possibilities of mistakes in opposite directions don't cancel each other out. For example, the possibility that Alan will sometimes get more than half doesn't offset the possibility that he will sometimes get less.

This has important consequences for how Ralph thinks about uncertainty. Suppose that Ralph was offered a different estate plan, which gave each child an equal chance of getting the whole estate. The "expected value" of each child's share is $400,000, just what Ralph wants. But from Ralph's point of

15. Each child has a 50% chance of getting $800,000 and a 50% chance of
view, this alternative is clearly worse than an estate plan guaranteeing each child a bequest of $400,000 — and this is true whether Ralph is neutral toward gambling, shuns it like the plague, or craves the bright lights of Las Vegas. What economists call risk aversion has nothing to do with this. The alternate estate plan offers two possible outcomes (depending on which child gets the whole estate). Since each uncertain outcome is less preferred than the equal split, a “lottery” between the two is also less preferred, regardless of risk aversion.16 For this reason, Ralph has a strongly negative attitude toward uncertainty. Consequently, he may find it worthwhile to invest in expert assistance in order to decrease that uncertainty.

Ralph actually has a choice about how to make that investment. He could hire appraisers now and use their information to allocate the cash between his children. This may be a good strategy if the value of the paintings is relatively constant. If their value fluctuates, however, it may be better to instruct the executors to obtain appraisals of the paintings as of the date of death and then divide the cash accordingly. Making an appraisal at the time of death is something like interpreting a statute: by being more careful, you can come closer to the drafter’s wishes.

The distinctive features of this model are that Ralph does not plan to have a continuing oversight role17 and that errors in opposite directions are not even partially off-setting. As a result, he has a strong desire for accurate implementation of his directives.18

The analogues in the statutory world are usually politically uncontroversial — the sorts of statutes that establish rules of appellate procedure, specify requirements for filing deeds, and getting nothing. If you ran a whole series of such gambles, the average payout to each child would be $400,000.

16. Which would you rather have, $10 or the following gamble: a 50% chance of winning $9 and a 50% chance of winning $8? (If you prefer the latter, please give me a call; some of my colleagues would like to engage you in a friendly game of poker.) To be attractive, a gamble has to offer some chance of profit; even an addicted gambler is unlikely to make a bet which is a certain loss. Either of the two outcomes in the alternate estate plan, however, is worse than the alternative of not gambling and sticking with the guaranteed even split.

17. Or at least, if he does plan to keep an eye on things, he’ll have to rely on a Ouija board to communicate his views from the Great Beyond.

18. Ralph is much like Posner’s hypothetical platoon commander in this respect. R. POSNER, THE PROBLEM OF JURISPRUDENCE 269 (1990). Indeed, Model 1 is a close analogy to Posner’s hypothetical.
establish contract rules between merchants. They tend to be uncontroversial because they are aimed at improving efficiency without favoring any particular group in an obvious way. Because of the lack of interest-group involvement, they will only sporadically make their way back onto the legislati agenda. (This doesn’t mean that the supporters of the original legislation lack interest in its effects. They may feel strongly about the issue, but they realize that their ability to legislative on the issue is due to fortuitous circumstances; they cannot expect the details of implementation are likely to attract much attention from their successors.) Consequently, continuing legislative oversight is unlikely. Also, errors in application are cumulative rather than offsetting. For example, the legislature might establish a filing system to provide an efficient method of tracking land titles. If the court erroneously gives effect to an unrecorded deed, the problem is only compounded if in another case the same court mistakenly holds a properly recorded deed to be ineffective. The two kinds of mistake simply do not “average out.”

The testamentary model suggests that judicial interpretation of such statutes should place a heavy value on correctness, so that countervailing values such as stare decisis should count for less. It also suggests that use of legislative history to determine the statute’s goal is appropriate because it allows the court to implement the legislature’s wishes more precisely at relatively modest expense. At the drafting stage, it is no surprise to find that, just as Ralph has an incentive to invest in the use of appraisers, the legislature often turns to experts to draft documents such as procedural laws and commercial codes.

B. **Model 2: “The Case of The Utilitarian Uncle”**

Our next model also involves a bequest. Benny Bentham (a distant relative of the utilitarian philosopher), wishes to provide for his two teenage nieces, Alice and Bernice. Like Ralph, he has an $800,000 estate. Unlike Ralph, however, he isn’t con-

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19. Another analogy might be to statutory provisions conferring financial benefits on interest groups (e.g., tax exemptions). The legislature might want the group to get the benefit of the statute but to have to return to Congress in order to get any more.

cerned with equalizing the sizes of the bequests. Instead, he wants to equalize the welfare of the two children as they are growing up, so he plans to give them each an income interest from a trust until they are of age. Like his famous ancestor, he believes that their utilities can be reliably determined; he doesn’t buy the modern economist’s skepticism about intersubjective comparison of utility.\textsuperscript{21}

Because Ralph and Benny both want to provide for their legatees equally, they might seem to face rather similar problems. But Benny’s situation differs in an important way from Ralph’s. Benny isn’t just concerned with how much money the two kids get. He’s also concerned with their needs. These are difficult to predict, and Benny doesn’t expect to be around while his nieces are growing up. Hence, he’s in a bad position to determine their proper shares. He could specify an even split of the trust income, but he would be taking the chance that changed circumstances would disadvantage one of the nieces. For instance, one of them might need expensive medical care or special schooling, or one’s family might become more affluent than the other’s. He might attempt to provide for all of these contingencies through elaborate drafting. This may be difficult and expensive, and quite possibly ineffective.

The obvious alternative is to delegate the task to a reliable trustee,\textsuperscript{22} perhaps providing some guidance about what factors the trustee should consider. On the benefit side, the trustee will be in a position to consider new information as it develops. Naturally, there are also some costs to entrusting this discretion to the trustee. The trustee may make mistakes, conceivably serious ones. It may be difficult to pick a trustee who will make such discretionary decisions wisely. Also, the trustee may have to be compensated for this potentially time-consuming task.

Benny’s attitude toward risk differs in an interesting way from Ralph’s. From Ralph’s point of view, mistakes are serious because any deviation from his preferred outcome is an unambiguous loss. From Benny’s perspective, mistakes by the trustee have a partially redeeming character: if the trustee makes a mistake and gives too little to one niece, he will give the excess to the other niece, increasing her utility, so it’s not a

\textsuperscript{22} Benny quite literally needs someone who is “trustworthy” to take on this task.
total loss. The extent of this offset is hard to assess without more precise information about Benny's preferences.

If we were to attempt a formal model of this situation, we would have to think quite carefully about how Benny's preferences relate to those of his nieces. An economist could assign them utility functions based on their own preferences, as revealed by the choices they would make between different consumption options. But Benny probably has different preferences about their choices than they do themselves. Being an old fogey rather than a teenager, Benny is likely to think that they have too short a time horizon and too little risk aversion. His own preference function simply will not incorporate the current preferences of the two nieces.

If Benny does decide to delegate the ongoing division of the income, he obviously wants the decisionmaker to be a neutral party without a bias in favor of either niece. For example, he will not want to appoint the parents of one niece to the position. He also will want to ensure that the nieces cannot offer strategic incentives to the decisionmaker. The law of trusts comes to his assistance with strict rules about conflicts of interests by fiduciaries. A legislature, similarly, might wish to ensure the neutrality of its interpretative agent. In this setting, the article III guarantee of life tenure for federal judges may serve the same function as the traditional restrictions on fiduciaries.

The obvious analogies here are to the so-called "common law" statutes — those that establish some general standard and leave to the courts the task of fleshing out the standard's meaning. The Sherman Act is the classic example. Unable to specify all of the actions that might be anti-competitive in some future situation, Congress left it to the courts to define the contours of the laws. In this setting, the courts play the same role as the trustees of a testamentary trust.

This model sheds some light on the role of stare decisis in common law statutes. Precedents under statutes such as the Sherman Act carry a weight akin to that of common law precedents, so that there is no "super-strong" rule of stare decisis as there is in other statutory settings. This makes good sense in terms of the trust analogy. Benny's reason for using a trustee is that judgments need to be made on the spot to take account of changing circumstances. The trustee should not be required

to divide the trust income the same this year as she did last year — if Benny had wanted a static division, he could have established the allocation himself. So Benny would not want the trustee to view last year's allocation as a completely binding "precedent." At the same time, the beneficiaries would suffer if their incomes fluctuated wildly and unpredictably, so the trustee should take account of their interest in stability. As a result, we would expect the trustee to give some weight to stability but to change the allocation when clearly warranted by new information or changed circumstances. The approach to precedent in Sherman Act cases seems strikingly similar.

So far, we have been thinking in terms of a testamentary trust, on the assumption that the legislation is a one-shot effort. Suppose, however, legislators expect to engage in ongoing supervision of the interpretative process. The coalition behind the law may expect to be a durable majority or at least to control the relevant committees. (Note that I am treating the majority coalition, rather than Congress as an institution, as the testator.) Here, the better analogy might be the inter vivos trust. If Benny expects the trust to operate while he is still around to keep an eye on things, he is likely to want to reserve some control over the trustee's exercise of discretion. Benny may retain the power to modify the trust, replace the trustee, or even disapprove individual decisions by the trustee. He still will want the trustee to be insulated from direct pressure from the beneficiaries. (If they are going to try to influence someone, he'd rather they give their attention to him.) Similarly, an ongoing legislative coalition might favor a delegation to an independent agency, because agencies (even if they are theoretically under presidential control) are strongly influenced by congressional oversight and budget control. The independent agency might be preferred over a court because it is more amenable to legislative control while still retaining some insulation from direct political influence by the regulated parties.

If this analogy holds, we would expect the attitude of reviewing courts toward agencies to be something like that of judges toward trustees. In trust law, the trustee's exercise of discretion is subject to a lenient standard of review, and will be set aside only for bad faith or some other abuse of discretion. The court's primary role is to ensure that the trustee actually is making a good faith effort to follow her instructions and is acting within the scope of her discretion. More intensive judicial review would make little sense — Benny chose the trustee, not
the judge, to make the discretionary decision about how best to implement Benny's purpose.

In administrative law, courts are similarly reluctant to overturn the interpretations of administrative agencies. In *Chevron, U.S.A., Inc. v. Natural Resources Defense Council, Inc.*, the Court strongly endorsed the role of agencies in statutory interpretation. If the statute does not clearly address an issue, under *Chevron* judges must defer to the administrative construction. The *Chevron* rule is based on the premise that Congress delegated policymaking discretion to the agency rather than the courts. The resemblance between the *Chevron* rule and trust law seems unmistakable. Although the precise contours of the *Chevron* rule are debatable, its basic rationale is well-supported by this private-law analogy.

II. CONTRACTUAL MODELS

At this point, we switch from Trusts & Estates to Contracts. Economics is better geared to modeling market transactions than testamentary dispositions, so this switch brings with it some modeling advantages.

I am going to abstract away from one extremely important aspect of contract law involving the dynamics of renegotiation. The possibility of strategic breach or threats to breach is an important factor in contract law. Although statutes may in some sense be "deals," they do not share this feature. Legislators cannot breach a statute in the way that businesses breach a contract. Legislators can, of course, breach various side-agreements, such as logrolling deals. But they don't have the option of violating a statute and risking a damage payment to other legislators. Because they can't threaten to unilaterally halt performance of the statute, the dynamics of renegotiation are also quite different. To exclude this factor from the model, I will focus on contracts in which the only issue is dividing the profits from an enterprise. I will simply assume, rather arbitrarily, that the parties will not seek to better their situations through opportunistic conduct during the performance of the contract.

Despite this important distinction between contracts and statutes, contract models capture an important aspect of statutory interpretation that is missing from the testamentary mod-

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25. Id. at 844-45.
26. For example, it isn't clear what discount rate a rational testator would use for post-mortem events.
A will typically reflects the preferences of a single individual. A contract, however, is an arrangement by two parties whose preferences differ and whose interests are partially conflicting. Many statutes are the result of coalitions between legislators of differing views, and are therefore more like contracts than wills. The two contractual models attempt to illuminate this aspect of legislation.

A. Model 3: “The Case of the Corporate Compromise”

This model involves a dispute between two publicly held corporations. For the sake of concreteness, let’s say they are called the Peach Computer Company and Moon Computers, Inc. Peach claims that certain basic design features of Moon’s machines infringe on Peach’s patents. Because Peach’s claims are fairly strong, the companies agree to a settlement giving Peach a 50% share of Moon’s profits. The crucial drafting problem is defining the term “profits.” The drafters might choose to draft a very specific but highly complex set of accounting rules. Another choice is to leave the term vague, allowing its meaning to be settled during the performance of the contract or, if necessary, through arbitration. Another option is to require profits to be determined by reference to standard accounting practices, which may change over the course of the contract. In deciding whether to hammer out a specific contractual definition or adopt one of the other alternatives, the parties must consider the possibility that a more dynamic alternative will ultimately result in an interpretation adverse to their interests.

Superficially, their problem seems rather similar to that of Ralph Rawls, our testator in Model 1. Like Ralph, they wish to arrange an even division of property but have a definitional problem. It is tempting to assume that, like Ralph, they place a great deal of value on certainty and have a strong interest in avoiding the risk of an uneven division. Actually, though, their situation is quite different.

From Ralph’s point of view, any deviation from equality is undesirable, regardless of whom it favors. But this is not true of Moon and Peach. Any mistake that harms one will thereby favor the other. If the contract is properly drafted, the possible mistakes will be offsetting.

27. This may not be true of a joint will by two spouses or where there is a will contract, but even there the preferences of the spouses at the time of drafting presumably are likely to be largely congruent.
The parties may anticipate a bias on the part of the eventual interpreter, perhaps based on sympathy with one of the parties. As long as this possible bias is known to both parties, however, it is irrelevant to drafting the definition of "profits." Suppose, for example, that a future court is likely to be biased in favor of Peach, or that the accounting conventions are likely to shift in Peach's favor. In either case, Moon's expected share of the profits is less than the nominal 50%. If the balance of bargaining power between the parties dictates a 50-50 split, as we are assuming, Moon can bargain for a nominal figure in excess of 50%, so that its expected share will be brought up to 50%. At this new figure, errors are just as likely to push Moon below an actual share of 50% as above it. Having a biased decisionmaker is like having a watch that is always five minutes late: so long as the error is known, it can be compensated for readily.

Conceivably, the parties might disagree about the existence of a possible bias, or they might be concerned about how unsophisticated outsiders will view their deal. But at least as a first approximation, it seems reasonable to assume that the relevant parties are sophisticated and fully informed about possible biases. Therefore, we can assume that the nominal terms are set so as to cancel out any predictable bias in interpretation.

Consequently, in this model, we can assume that the parties anticipate that, on average, each will get half of the profits, despite any possible interpretational errors. They are each still taking the chance, however, that they actually will get less than half. In short, they still face a risk of misinterpretation, and one might think they have a strong interest in avoiding that risk. There is a good basis, however, for thinking that they should be fairly indifferent to that risk.

The reason is that Moon and Peach are publicly held corporations. By and large, their attitudes toward risk should reflect the interests of their shareholders. The shareholders themselves are likely to be risk averse, but finance theory indicates that they should seek to protect themselves against risk by holding diversified portfolios, not by favoring risk-averse

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28. For example, maybe Peach's shareholders will regard a split nominally favoring Moon as a big defeat, not understanding that the real split is more even.

29. This assumes that while the courts are biased in their interpretations, they are not willing simply to mandate (perhaps covertly) a predetermined split regardless of the language of the contract.
management of the companies. So we should expect the corporations themselves to behave in a risk-neutral fashion. This means that the corporations should make decisions based on expected returns rather than the spread of possible returns. That is, corporations should be neutral between a guaranteed return of $1 million and a 50% chance of making $2 million. On average, the gamble will pay off $1 million, and this should be the corporation's only concern. In Model 3, Peach and Moon know that their expected percentage of profits will be 50%; the uncertainty on both sides of this figure caused by possible interpretational errors should be a matter of relative indifference.

This has some surprising implications for drafting. Essentially, the corporations have very little reason to eliminate interpretation errors, and therefore little reason to desire a detailed, comprehensive contract. Thus, their basic inclination should be to settle on very vague terms, taking the risk that the later interpretation of the contract will favor one party or the other. Their strongest reason to care about specificity relates to transaction costs; it may be easier to negotiate specific terms to cover a contingency as part of an overall package rather than bickering after the problem has materialized. Yet, much of the drafting effort is likely to be wasted on terms designed to cover situations that never actually happen. Even if it is worth negotiating specific terms immediately, the corporations won’t care about the precise terms so long as they work out to a fifty-fifty split. Assuming Peach and Moon have equal confidence in their lawyers, they will be willing to agree to the fifty-fifty split and leave it to the lawyers to hammer out the details (taking the risk that their own legal gladiators may do worse than expected).

This model seems to account for an important — and to lawyers, puzzling — aspect of business behavior, which is the willingness to make important business deals “on a handshake” without working out any of the terms that lawyers think are so important. The reason is that specific terms have only secon-

30. For extensive discussion of the realism of this assumption, see Gillette, Commercial Relationships and the Selection of Default Rules for Remote Risks, 19 J. LEGAL STUD. 535 (1990). In the situation in the text, the risk can be eliminated simply by holding shares in both companies.

31. Also, if the future negotiating costs are the same as the present costs, it is worthwhile to defer the expenditures because of the “time value of money”: a dollar spent today is equivalent to a greater amount tomorrow due to the accrual of interest. See infra note 42.
dary importance to the corporations because they affect risk rather than expected return.

To the extent that a legislative "deal" looks like Model 3, then, we would expect legislators to take little interest in interpretative risks. They are likely to choose open-ended terms, and where there are trade-offs between interpretative accuracy and other costs, to place a lower value on interpretative accuracy. Thus, for instance, they are likely to prefer a cheap if less accurate method of dispute resolution, such as arbitration, to the possibly more accurate but cumbersome process of litigation.

Some of the classic regulatory statutes may fit this model, particularly if we accept the common view among economists that these statutes were at least partly passed to benefit the regulated industries themselves. For example, the Natural Gas Act requires that pipelines charge a "reasonable" rate, which could be seen as a compromise between pipelines and oil producers. The existence of this open-ended standard fits Model 3 rather well. In applying this standard, the agency might err in either direction, and these errors are mutually offsetting. Moreover, shareholders' risk aversion would not be a serious problem. Because the Act only regulated one industry, any risk can be neutralized by holding a diversified portfolio.

This model treats statutes and their interpretation as just another set of events impacting on a business, so that an unexpected action by Congress or the courts is viewed by the business in just the same ways as an unexpected movement in exchange rates or oil prices. Legal scholars, of course, treat one set of events as involving mere fortuities while the others involve issues of principle, and perhaps business people occasionally feel the same way. Ultimately, however, it is the bottom line that matters in business.

One might think, as Judge Easterbrook has said, that legislators would place little weight on stare decisis. Deals, as he points out, must be kept to be believed, and stare decisis allows the deal to be changed as the result of an interpretation error. Actually, however, it is much less clear in Model 3 that stare decisis is disfavored.

32. For a summary of the literature, see D. FARBER & P. FRICKEY, supra note 2, ch. 1.
Because interpretative errors can be expected to average out, the supporters of such legislation would give little weight to interpretative accuracy as opposed to other factors. As we have seen, this may lead them to draft open-ended statutes in order to avoid complex negotiations over the particular terms. It also will lead them to favor strong stare decisis rules. Instability of legal rules involves inevitable transaction costs (such as greater litigation). At the time of enactment, because a future mistaken interpretation of the statute is as likely to favor one side as the other, the framers of the statute would place a greater weight on eliminating these transaction costs than on avoiding interpretation errors. Thus, one would expect a strong presumption in favor of stare decisis.

For similar reasons, the framers have little reason to favor the use of extrinsic evidence to interpret their bargain. Reference to extrinsic evidence creates two kinds of expenses: higher lawyering costs at the time of the litigation, and higher lobbying costs at the time of enactment (as the parties struggle to create favorable legislative history). On average, the mistakes cancel out anyway, so it isn’t worthwhile to incur these transaction costs in the hope of a more accurate interpretation of the statute.

B. MODEL 4: "THE CASE OF THE SEPARATING SPOUSES"

The conclusions in Model 3 are shaped heavily by the risk neutrality of the corporations entering into the contract. Suppose instead that we have a divorce settlement between two

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35. The existence of a stare decisis rule makes the outcome of the first case involving a novel issue more important, since it will control future outcomes. Thus, the parties will invest more in litigating that case than they would in the absence of a stare decisis rule. But unless the optimum legal investment in a case is a linear function of the stakes, the increased initial fee will still represent a cost saving compared with the expense of repeated litigation. The non-linearity assumption means that if it is worth spending $100,000 to litigate a $1 million case, it only is worth spending some amount less than $10 million to litigate a $100 million case, given cases of equal legal and factual complexity. This assumption seems reasonable. It seems unlikely that, for example, that doubling the number of lawyers working on a brief will have a proportionate effect on the expected outcome of the case. The realism of this assumption is supported by the fact that people with multiple litigation find it worthwhile to set up test cases to govern the outcomes of all these cases. In other words, parties who are not risk averse find it worthwhile to use the first case on an issue as a test case to decide the legal issue, rather than relitigating the legal issue repeatedly.
risk-averse individuals, George and Martha.\textsuperscript{36} As in the previous model, let's say that the settlement will take the form of a half share of a business — in this instance, we might say that George runs a small business. Again, the problem is that the term "profit" is not easily defined and may be subject to later dispute.\textsuperscript{37}

Because the parties are risk averse, their attitude toward uncertainty is much different from that of the corporations in Model 3. The fact that the corporations can each expect half the profits means that the possible adverse outcomes are balanced by the possible favorable ones. But for the risk-averse person, the risk of losing money weighs more heavily than the equal chance of winning the same amount of money. As a consequence, unlike the corporations in Model 3, George and Martha have a strong incentive to narrow their risks by sharpening the definition of profits in the contract. Thus, in Model 4, the parties place a higher value on clarity than in Model 3.

Firms are usually risk neutral, while individuals are not. Hence, Model 4 best fits statutes that resolve important conflicting interests between groups of individuals. Title VII, the federal employment discrimination statute,\textsuperscript{38} contains a nice analogue to Model 4. Because of the central economic importance of employment for most people, employment-related risks are often large and not easily diversifiable. Hence, a dispute between two groups over the right to certain jobs comes close to Model 4. Just such a conflict is present in Title VII, and in order to pass the statute it was necessary for civil rights advocates to strike a deal with union leaders to protect seniority rights.\textsuperscript{39} Courts have made a strong effort to stay close to the original bargain, even at the expense of the overall purpose of Title VII.\textsuperscript{40}

\textsuperscript{36} A colleague suggested Homer and Marge Simpson as alternative names.

\textsuperscript{37} To prevent the more obvious forms of shenanigans by George, let's say that the business is carefully audited, so that he can't just hide the money. Also, he's a workaholic and won't decrease his efforts because of the settlement.


\textsuperscript{39} See International Bhd. of Teamsters v. United States, 431 U.S. 324, 348-56 (1977) (reviewing the legislative history of Title VII relating to seniority systems).

Model 4 also offers an opportunity to explore another intriguing, if difficult, issue about the temporal dimension of interpretation. Assume that there are two definitional issues regarding the profits from George's company, one of which will change the amount of profits next year by $10,000, while the other has the same impact on profits five years down the road. (Perhaps one item, if allowable, will offset an income receipt next year, whereas the other will go into the basis of an asset to be sold in five years). Which one will the parties care the most about?

The answer is, of course, the more immediate item. Future amounts have to be reduced to present value through discounting, so that the present value of the more immediate amount will be greater. One way of seeing this is to observe that at a 10% interest rate, you would have to put $9,090 in the bank today to have $10,000 in a year, but only $6,210 to have that amount in five years. This is a $2,880 difference. Conversely, by waiting five years for a payment, you forego all the interest you could have earned in the meantime.

Indeed, risk aversion makes this effect even more pronounced. Risk-averse investors add a risk premium to their interest rate. As a result, the difference in present values will be even greater. As an illustration, suppose they move from a 10% rate to a 15% rate because of risk aversion. Then the difference in present values goes from $2,800 to $3,730, and the more immediate item weighs almost twice as strongly.

Thus, given two otherwise identical gambles, risk-averse parties will be more concerned about the one that will arrive soon, and care less about one in the distant future. Where the

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41. For a good introductory treatment, see J. HIRSCHLEIFER, supra note 21, at 442-72.
42. See the table in R. BREALEY & S. MYERS, PRINCIPLES OF CORPORATE FINANCE 744 (1981).
43. I am assuming here and throughout this discussion that the risk is undiversifiable. Otherwise, George and Martha would just diversify their portfolios and thereafter behave like the risk-neutral shareholders in Model 3.
44. At a 15% rate, the present value of $10,000 in one year is $8,700, while the present value of $10,000 in five years is only $4,970. See the same table in R. BREALEY & S. MYERS, supra note 42, at 744.
45. This is a crucial assumption. If the size of the "stakes" grows as fast as the discount rate, future and present rights will weigh equally. This might happen, for example, if a statute regulates a rapidly growing industry.
46. Another way to see this is to think about insurance premiums. Suppose someone would be willing to pay a $100 insurance premium to cover a 10% chance of a $800 loss today. To make the arithmetic easy, let's assume a 5% discount for amounts one year in the future. How much would the same
risks involve interpretation, they will care more about misinterpretations in the near future than about later misinterpretations. (Risk-neutral parties, on the other hand, don’t care much either way about the reliability of interpretations so long as they can predict the average outcome.) This fits the common intuition that drafters care much more about how a document will be interpreted in the short-run than about long-term consequences. Even opponents of originalism in constitutional law, for example, usually concede that recent constitutional amendments should be construed on the basis of original intent.\footnote{See, e.g., Brest, The Misconceived Quest for the Original Understanding, 60 B.U.L. Rev. 204, 229 (1980).}

Similarly, under Model 4, the enacting legislature would desire that courts pay close attention to legislative history (despite some higher transaction costs), particularly in the early years of the statute’s implementation.\footnote{We need to be careful in assigning discount rates to legislators. If they are acting as agents for interest groups, it is the interest groups’ discount rates that count, not the legislator’s personal time preferences.}

Model 4 also has interesting implications for stare decisis. Looking ahead, risk-averse contractors can foresee the following scenario. Somewhere down the road, the court may make a mistake in interpretation. There will then follow a period of uncertainty while everyone waits to see if the mistake is corrected. This uncertainty will result in unavoidable transaction costs (such as increased lawyering expenses of various kinds), regardless of whether the court ever overrules itself. After some further time period, the court may reverse itself.

Notice that the reversal is less likely and comes farther down the road than the transaction costs. Because they are risk averse, the parties will view the certainty of higher transaction costs as relatively more important than the contingency of a beneficial overruling — risk-averse people don’t like to gamble. Moreover, risk aversion means, as we have seen, the use of a higher discount rate, so that the transaction costs also get a higher weight because they will come sooner. For both reasons, the parties will give the prospect of an overruling less relative weight than the transaction costs. (And don’t forget that each party knows that the initial error may be in its own direction,

\begin{equation}
\text{The present value of the possible loss is $760, so from a present value perspective, the individual faces a 10\% chance of a $760 loss — in other words, the loss has shrunk by 5\%. The risk premium, however, should shrink by somewhat more than 5\% because risk aversion is not a linear function of loss: large losses are proportionately more feared than small ones.}
\end{equation}
so that only half of the overrulings will be desirable from its perspective.) The bottom line is that correcting interpretative mistakes is less attractive than one might expect, even for the risk-averse. Unless the mistake is a particularly serious one, so that the benefits of correction loom large, risk-averse parties would prefer to apply stare decisis. This means that, contrary to Judge Easterbrook's suggestion, stare decisis may be sometimes favored even at the expense of fidelity to the original "deal."\(^{49}\)

Although both Models 3 and 4 support stare decisis rules, they do so to different degrees. In Model 3, the corporations have very little reason to care about the correctness of any particular legal interpretation, so long as they expect errors to average out. Hence, correcting erroneous interpretations is simply not a matter that concerns the parties \textit{ex ante}, and a strong stare decisis rule is attractive. In Model 4, however, the individuals do care \textit{ex ante} about mistakes, even if they expect errors to average out. This fact, taken alone, would incline them toward giving no weight to precedent at all, but countervailing factors exist relating to transaction costs and the time value of money. Because of these countervailing factors, Model 4 leaves room for a stare decisis rule, but the binding effect of precedents can be expected to be lower than in Model 3. So in Model 3 we would expect a "super-strong" rule of stare decisis, but not in Model 4.

CONCLUSION

If I had a bevy of bright graduate students at my command,

\(^{49}\) This conclusion should be contrasted with Model 2, where stare decisis carries less weight. A fifth model might blend aspects of Models 3 and 4. A statute might represent a deal between parties with different discount rates or different attitudes toward risk. For example, firms are generally thought to use higher discount rates than individuals because of corporate-level taxes: in order to give their individual shareholders their desired rate of return, the corporation itself must earn a higher rate of return. See Baumol, \textit{On the Social Rate of Discount}, 58 AM. ECON. REV. 788, 793-96 (1968). A statute might well be a compromise between industry interests and representatives of consumer or taxpayer interests. Such a deal would probably give the industry benefits up-front, with a longer payout period for the individuals. In the area of taxation, for example, this would mean long-term tax reforms, which benefit individual taxpayers collectively, combined with favorable transition rules for industries. When statutes combine a public interest provision with specific exemptions for some firms, the optimum bargain for the parties places more weight on the general interest side of the bargain as time goes on. Thus, courts should give a broader interpretation to the public interest terms at the expense of special interest proviso as the statute ages.
I would send them off to improve the private-law models in various ways. One of my goals would be to increase their adequacy as models of private law interpretation. I would direct one group to formalize the models mathematically and add plenty of intimidating references to convex hypersurfaces and fixed-point theorems. Another group would be asked to augment the models by incorporating features such as post-contracting strategic conduct or gap-filling issues.

My other assistants would try to deal with some of the limitations of economics. One task force would try to come to grips with some of the shortfalls of the economic theory underlying the models. For example, there is considerable evidence that individuals are not rational in either their responses to risks or their discount rates. It would be nice to know how many of my conclusions would survive more realistic modeling. I would ask a final group (maybe philosophy Ph.D students rather than economists) to think about how the models themselves (and private law interpretation more generally) relate to the non-economic theories of interpretation proposed by philosophers and literary theorists. All of this would require, of course, hefty research funding, which would free me to read murder mysteries instead of teaching, while my grad students slaved away at a series of articles under my name.

There is also a great deal of work to do on the public-law side. The models all assume, rather naively, that the normative goal is to implement the desires of the enacting legislature. At any one time, our society is involved in passing new statutes and is subject to regulation under a variety of old ones. Presumably, the present members of society would like a set of interpretative rules that responds to our preferences in both capacities. The models in this Essay respond only to the first set of preferences and do so imperfectly, because they essentially assume that social preferences and legislative preferences are identical. From the normative end of things, then, the models are far from definitive.

50. For a summary of this research, see Noll & Krier, Some Implications of Cognitive Psychology for Risk Regulation, 19 J. LEGAL STUD. 747, 754-60 (1990).


On the descriptive side, the models are also over-simplified. Essentially, they assume that the enacting legislators either share the same view of the ideal outcome (the testamentary situation), or else are split into two camps which are seeking to reach a compromise (the contracting situation). But legislatures can have other configurations. Notably, instead of being split into two camps, the legislators may be spread out along a spectrum. The median legislator may then determine the substance of the legislation. Because the legislation is close to that legislator's ideal outcome, she is in something like the position of the testator in Model 1. For her, errors in one direction are as bad as errors in the other. But other legislators are ranged on opposing sides of the issue, so from their perspective the situation looks something like the contracting model, in which the outcome is a compromise between two opposing parties. It isn't clear how an interpretation model should deal with the diverse perspectives of these various legislators.53

In short, it seems to me that there is great room here for additional research. If this Essay prompts some scholarship in that direction, it will have served its purpose. But even the crude models offered here, I believe, can illuminate issues of statutory interpretation. I have also found the private law analogies useful in the classroom. For example, in a constitutional law class where none of the students could see any argument for originalism, Bork's analogy to will interpretation began to give them a grasp of that perspective.

Perhaps the greatest lesson here, however, is how quickly even simple private law models become complex. Interpretation looks different for wills than for contracts, and different for contracts between corporations than contracts between individuals. If anything, the realm of legislation is much more complex and untidy. Simply because of this complexity and messiness, we are badly in need of the guidance that even a rough theory can provide. But we will blunder badly if we forget how much our theories shortchange reality.

53. Other complications include the presence of "gatekeeping" committees and the possibility of a veto. For an attempt to include these within the model, see Eskridge, Reneging on History? The Court/Congress/President Civil Rights Game, 79 CALIF. L. REV. — (forthcoming) (1991).