



1-1-2019

A Behavioral Economics View of Judge Posner's Contracts Legacy

Deborah R. Gerhardt

University of North Carolina School of Law

Follow this and additional works at: <https://scholarlycommons.pacific.edu/uoplawreview>



Part of the [Law Commons](#)

Recommended Citation

Deborah R. Gerhardt, *A Behavioral Economics View of Judge Posner's Contracts Legacy*, 50 U. PAC. L. REV. 349 (2019).

Available at: <https://scholarlycommons.pacific.edu/uoplawreview/vol50/iss3/5>

This Symposium is brought to you for free and open access by the Journals and Law Reviews at Scholarly Commons. It has been accepted for inclusion in The University of the Pacific Law Review by an authorized editor of Scholarly Commons. For more information, please contact mgibney@pacific.edu.

A Behavioral Economics View of Judge Posner's Contracts Legacy

*Deborah R. Gerhardt**

It is an interesting time to reflect on Judge Richard A. Posner's legacy and his notion of rational decision-making. In 2017, Richard H. Thaler, Judge Posner's colleague at the University of Chicago, won the Nobel Prize in Economics.¹ Even if Judge Posner is gracious and pleased for his colleague, it must have been tough to accept that Thaler won the coveted prize for work that undercuts Judge Posner's brand of traditional law and economics. Judge Posner's prodigious legacy affirms the traditional economic tenet that people and markets behave rationally. Thaler won the Nobel Prize for his work establishing quite the opposite: people are predictably irrational and consistently behave in ways that defy Judge Posner's brand of economic theory.

Legal analysis has not sufficiently adjusted by applying behavioral economic theory to contract law. This Article contributes to filling that gap by considering the following questions. How does the economic analysis of law account for irrational behavior? If our choices do not always result from linear, rational thinking, should we consider using behavioral economics to rethink our understanding of contract law? If we can agree that behavioral economics challenges the theoretical coherence of rational economic reasoning, should we view behavioral economics as a substitute or adjunct to law and economics? Given the explosion of work in behavioral economics that has reshaped our understanding of how decisions are made, how can we retrofit Judge Posner's influence on the legal academy?

Part I briefly describes Posner's brand of traditional law and economics. Next, it identifies several ways behavioral economics calls his theory into question. Part II illustrates how the patterns identified in behavioral economics provide important tools for understanding judicial decision-making in contracts cases. Part III demonstrates that amoral blind faith in traditional law and economics can provide a climate for the growth of markets that are a serious threat to public health and safety, such as markets for nondisclosure agreements used to silence victims of sexual misconduct.

*Deborah R. Gerhardt is an Associate Professor of Law at the University of North Carolina School of Law. I am grateful to Michael Malloy and my fellow panelists and participants at KCON XIII for this opportunity to reflect together on Judge Posner's legacy. I am also most grateful to Chandler N. Martin and Sara Jane Françoise Anderson for excellent research assistance.

1. Richard H. Thaler, *Prize Lecture: From Cashews to Nudges: The Evolution of Behavioral Economics*, NOBEL MEDIA (Dec. 8, 2017), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/2017/thaler-lecture.html (on file with *The University of the Pacific Law Review*).

II. BEHAVIORAL ECONOMICS CHALLENGES POSNER'S ASSUMPTIONS ABOUT RATIONAL DECISION MAKING

Judge Posner's work has profound theoretical appeal. His economic view of the world is clear and neatly ordered. He believes that if you ask what a rational person would choose in a given situation, traditional law and economics provides an answer based on utility maximization.² This disciplined approach gives us elegant, straight-forward analytical tools that have been used to modernize and streamline legal theory in many disciplines including contracts and intellectual property.

Judge Posner's writing style makes one want to convert. He writes persuasively, with clarity of vision. He illustrates his points with vivid imagery. He deftly applies his literary power to brush aside those who challenge his world view. He has dismissed the field of behavioral economics as a series of "cognitive quirks."³ Doubt does not burden him. He is brilliant and confident.

Judge Posner is a man on a mission to prove that his way of thinking is superior. In response to the behavioral economics claim that we make decisions irrationally, Judge Posner uses multiple rhetorical devices to dismiss the studies he does not like. He knows how to take a vivid example from everyday life, and in a single sentence, deep-six a competitive theory. To illustrate that we routinely dismiss our irrational fears and choose to make rational decisions, Posner points out that even if consumers have an irrational fear of flying, we behave rationally when buying airline tickets.⁴

Another technique he uses is disdain for those who think differently. He describes most legal scholarship as "frivolous, even narcissistic."⁵ Not so, he says, with law and economics, as it illuminates difficult issues in federal cases and generates legal reforms that fix them. Join us, he beckons, and you will not be an irrelevant navel gazer. You will be among the elite who see clearly. Reach for the incisive tools of law and economics, and you will have the power to navigate the world persuasively.

Economic analysis of law explains all human behavior as gathering an optimal amount of information and acting to maximize its utility.⁶ When Judge Posner talks about maximizing utility, he means maximizing wealth. Economists famously assume that people behave rationally, gather optimal information before making decisions, and act to maximize their utility. Even when they acknowledge the instances in which these tenets are not literally true, they say that the theory gets

2. Richard A. Posner, *Rational Choice, Behavioral Economics, and the Law*, 50 STAN L. REV. 1551, 1559 (1998).

3. *Id.* at 1553.

4. *See id.* at 1559 n.16.

5. RICHARD POSNER, *DIVERGENT PATHS: THE ACADEMY AND THE JUDICIARY* 33 (2016).

6. *See* GARY S. BECKER, *THE ECONOMIC APPROACH TO HUMAN BEHAVIOR* 14 (1976) ("All human behavior can be explained to constitute participants who maximize their utility from a stable set of preferences and accumulate an optimal amount of information and other inputs in a variety of markets.").

close enough because it has predictive power. Posner defines rationality as “choosing the best means to the chooser’s ends.”⁷ This view of rationality is not about tempering impulses or passions.⁸ Rather, it is a calculation for the purpose of maximizing utility. “It only requires adjusting beliefs to the available evidence and acting consistently with your preferences given the constraints and opportunities in your situation.”⁹ That definition is so broad, it can cover any self-interested choice. If people act rationally when they choose what they prefer, there is no limit to what is rational.¹⁰

The enduring legacy of Posner’s traditional law and economics as a predictive tool is now in question. Actual human decision-making turns out to be not so neatly ordered. A rising tide of behavioral economists are conducting studies showing that we often make decisions in predictable ways that are more nuanced and less rational than those Judge Posner describes. Behavioral economists have identified numerous ways in which we make decisions that do not conform with the rational decision-making model championed by Judge Posner. Instead of navigating our world as described in classical economic theory, we repeatedly make choices that are predictably irrational. In 1998, Christine Jolls, Cass Sunstein, and Richard Thaler identified three paradigms for applying behavioral economic principles to law. Each illustrates how traditional economics fails to explain actual decision-making.¹¹ Instead of acting rationally according to the assumptions of traditional economic analysis, they showed that people display “bounded rationality, bounded will-power, and bounded self-interest.”¹² In addition to revealing the limits of human rationality, they identify how irrational behavior follows patterns that may be modeled to explain and predict specific outcomes. Since then, many studies have validated their assertions.

Each of these patterns reveal important critical perspectives on Judge Posner’s analysis of contracts. The first set of behavioral economics heuristics fall under the Jolls, Sunstein, and Thaler category of “bounded rationality” and is based on the work of Daniel Kahneman.

A. Bounded Rationality Heuristics

In 2002, Daniel Kahneman won the Nobel Prize in Economics for his work showing that prospect theory is a more accurate description of human behavior than utility theory. Prospect theory explores how humans actually deal with risk. It posits that when evaluating risk, people do not behave according to the script

7. Posner, *supra* note 2, at 1551.

8. RUTH W. GRANT, STRINGS ATTACHED: UNTANGLING THE ETHICS OF INCENTIVES 55 (2012).

9. *Id.*

10. See Christine Jolls et al., *A Behavioral Approach to Law and Economics*, 50 STAN. L. REV. 1471, 1488 (1998).

11. *See id.*

12. *Id.* at 1476.

written by traditional economists. Instead of making rational choices based on all available information, people often use heuristics, which are patterns of discarding all information in favor of short-cuts or rules of thumb. The heuristics of availability, loss aversion, the endowment effect, and arbitrary coherence have particular relevance to contract theory.

The availability heuristic explains how we process probability and risk. Instead of weighing all available information equally, we are biased in favor of what we know or have seen before. Our “judgments about probabilities will often be affected by how ‘available’ other instances of the harm in question are, that is, on how easily such instances come to mind.”¹³ The availability effect is a processing bias that clouds our ability to think rationally and can affect a variety of contracts scenarios. It can help explain gap-fillers and objective theory. But if it is ignored, it may prejudice anyone seeking to enforce an atypical agreement, especially if an experienced jurist has many typical scenarios in his or her memory bank.

Another prospect theory heuristic relevant to judicial interpretation of contracts is that humans attach to what we have in addition to what we know. In a series of experiments, Kahneman explained this endowment effect—that people place higher value on goods they own than those owned by others. A corollary idea, known as loss aversion, is that losses are felt more deeply than gains. Both patterns are reflected in an experiment conducted by Dan Ariely, a Professor of Psychology and Behavioral Economics at Duke University,¹⁴ home of the Blue Devils.

Attending a Duke home basketball game is an unforgettable experience. Cameron Indoor Stadium is old and small. When the team does well, the whole stadium literally shakes with excitement. A section of seats is reserved for students, but the demand for tickets is always higher than the supply. Duke students camp out for days to enter a lottery, and some of those who wait in line are randomly selected to get tickets.

Professor Ariely realized that the market for these seats presented an ideal laboratory for an experiment on the endowment effect. Ariely selected 100 students who camped out for tickets to participate in his study. Before waiting in line for tickets, all students were similarly situated. They wanted Duke basketball tickets enough to camp out overnight for the chance to win the lottery. Half of the selected participants had won seats through the lottery; the other half had not. Consistent with both loss aversion and the endowment effect, the 50 students with tickets had become so attached to the idea of attending the basketball game that, on average, they would only agree to sell their seat for \$2,400. The 50 students who did not have tickets were willing to pay only \$170. Ariely explains that we “fall in love with what we already have.”¹⁵ He continued to expand on our

13. *Id.* at 1518.

14. See DANIEL ARIELY, PREDICTABLY IRRATIONAL: THE HIDDEN FORCES THAT SHAPE OUR DECISIONS 172 (2008) (describing the experiment summarized in the following two paragraphs).

15. *Id.* at 173.

understanding of the endowment effect with experiments showing that the more we invest in our possessions, the more we feel attached to them. Ariely calls this version of the endowment theory the Ikea effect.¹⁶

Another behavioral pattern that reveals insights into human decision-making is arbitrary coherence. Traditional economists claim that we seek market information to make rational decisions about a fair price before deciding on a product's monetary value. Behavioral economists have demonstrated that our sense of value does not work that way at all. Instead, like ducks who imprint on their moms, we attach to our initial sense of a product's value.¹⁷ And even more disturbing, our beliefs in the fairness of "[i]nitial prices are largely 'arbitrary' and can be influenced by responses to random questions."¹⁸ In one of Ariely's studies, participants derived their sense of an object's worth from the last two digits of their social security numbers.

Behavioral economists have also shown we should doubt the traditional law and economics assumption that resources gravitate towards their most valuable uses. Traditionalists, like Posner, claim that people can be expected to suck the total value from all available money.¹⁹ Based on this reasoning, when gas prices fall, the rational person would use their surplus funds on things other than gas. Behavioral economists have shown that this is not actually how people behave. People treat a subset of their money as gas money.²⁰ When gas prices fall, a surprising number buy premium gas instead of transferring the extra dollars to other goods and services.²¹

Behavioral economists have revealed and tested fascinating dynamics about the nature of costs that differ substantially from those posited by Posner. Traditional law and economics thinkers, like Posner, focus on the point of purchase. In buying a consumer product or entering a commercial contract, Posner says that a forward-thinking, rational choice is made.²² Costs at this moment in time are opportunity costs.²³ Sunk costs are irrelevant because they do not affect the risks, costs, and benefits going forward.²⁴ In fact, behavioral economists have demonstrated that sunk costs matter and influence our decisions. Behavioral economists have shown that, in addition to having limits on our rational capacities, we are also easily tempted by the way information is presented and our sense of what is fair.

16. *See id.* at 135.

17. *Id.* at 33.

18. *Id.*

19. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* § 1.1 (2007).

20. *See* ARIELY, *supra* note 14, at 47.

21. *See id.* at 47.

22. RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 6–7 (8th ed. 2007).

23. *See id.*

24. *See id.*

B. Bounded Will-Power

Behavioral economists contend that our willpower, like our inclination to think rationally, is limited in predictable ways. Traditional economists claim that when we have relevant information, we will act rationally and not be influenced by the manner in which a problem is framed.²⁵ Thaler's work demonstrates that, in fact, we are easily tempted and do not have the willpower that traditional economists describe. A vast literature demonstrates that advertisements and descriptions impact our behavior. Consumers can be influenced by the way information is presented or how we acquire it. We are sometimes myopic. Even something as simple as the color of a product, a store, or an advertisement can exert persuasive force, without our knowing it.²⁶ One researcher studying the effects of color on marketing concluded that "[p]eople make up their minds within 90 seconds of their initial interactions with either people or products. About 62–90 percent of the assessment is based on colors alone."²⁷

Thaler has identified beneficial policy implications that can flow from acknowledging these heuristics. He convinced multiple institutions to adopt "opt in" defaults for a variety of beneficial programs. Through such real-world experiments, Thaler demonstrated that if participation in a savings plan or school lunch program is the default, more people participate.²⁸ If institutions acknowledge and act on Thaler's work, our tendency towards inertia may be recruited to work towards a preferred outcome.

C. Bounded Self-Interest

Another challenge to the law and economics model involves the behavioral assertion that people have a moral compass. Economists see the rational decision maker as self-interested and motivated by efficiency. Behavioral economists have shown that human decision-making is influenced by non-monetary values, such as fairness. It turns out that we are willing to sacrifice utility to others who are kind and punish those who are unkind, even if we do not benefit from doing so.²⁹ Studies documenting this sense of fairness indicate that we have expectations—a kind of true north of reference transactions—that define what is fair, and we are inclined to stick to these norms even if they do not always maximize our individual utility

25. *See id.*

26. *See, e.g.,* Hyojin Lee et al., *Monochrome Forests and Colorful Trees: The Effect of Black-and-White versus Color Imagery on Construal Level*, 41 J. OF CONSUMER RES. 1015 (2014); Benjamin H. Detenber et al., *The Emotional Significance of Color in Television Presentations*, 2 MEDIA PSYCHOL. 331 (2000); Gorn et al., *Waiting for the Web: How Screen Color Affects Time Perception*, 41 J. OF MARKETING RES. 215 (2004) (establishing that background color of a website affected perceived loading time).

27. Satyendra Singh, *Impact of Color on Marketing*, 44 MGMT. DECISION 783 (2006).

28. Richard H. Thaler & Shlomo Benartzi, *Save More Tomorrow™: Using Behavioral Economics to Increase Employee Savings*, J. POL. ECON. S164, S168–69 (2004).

29. *See* Jolls, *supra* note 10, at 1494.

for a particular transaction. For example, if vendors were driven only to maximize utility according to the changing forces of supply and demand, they would charge more for umbrellas on stormy days.³⁰ However, studies show that actual store owners generally do not raise umbrella prices when it rains.³¹ Behavioral economists explain that we have a reference point—an anchor in our minds of what umbrellas should cost—that affects what we are willing to pay, irrespective of the weather. That anchor affects what we will think of the vendor who takes advantage of our misfortune on a rainy day by raising prices.³² This type of thinking affects many markets. It can mean that employers are more likely to lay off some employees than cut wages for all of them.³³ Fair price anchors are also reflected in legislation that prohibits price gouging during hurricanes and other abnormal market disruptions.³⁴ This heuristic may also explain resistance to increasing the minimum wage.

III. BEHAVIORAL ECONOMICS AND JUDGE POSNER

The heuristics identified by behavioral economists can advance our understanding of judicial decision-making in contracts cases. Even a jurist as brilliant as Judge Posner is prone to using the availability heuristic and anchoring his understanding of certain issues to his particular reference transactions. Judge Posner’s experience reviewing business contracts has given him a frame of reference for the typical deal in many situations. When contract language strays from his sense of the norm, his irrelevant anchor of what is normal or reasonable may exert more persuasive force than the facts admitted into evidence.

Judge Posner’s decision in *Beanstalk Group, Inc. v. AM General Corporation*³⁵ reflects this concern.³⁶ The case involved a “Representation Agreement” in which Beanstalk agreed to promote AM General’s “Hummer” brand in exchange for benefits including 35% of “any agreement or arrangement, whether in the form of a license or otherwise, granting merchandising or other rights in the Property [defined as the Hummer mark].”³⁷ Before the contract’s term expired, AM General sold its rights in the Hummer mark to General Motors, which did not want to continue working with Beanstalk.³⁸ When AM General refused to pay Beanstalk 35% of the proceeds from the sale, Beanstalk sued for breach of contract, asserting that AM General’s sale of the Hummer mark was “an agreement

30. See ARIELY, *supra* note 14, at 172.

31. *Id.*

32. *Id.*

33. *Id.*

34. See, e.g., N.C. GEN. STAT. § 75-38 (prohibiting “excessive pricing during states of disaster, states of emergency, or abnormal market disruptions”).

35. 283 F.3d 856 (7th Cir. 2002).

36. See *id.* at 859–60.

37. *Id.* at 858.

38. *Id.* at 859.

. . . granting merchandising or other rights” in the mark.³⁹ The trial court granted AM General’s motion to dismiss the breach of contract claim.⁴⁰

The question on appeal, as in any motion to dismiss, was whether the plaintiff stated a claim upon which relief could be granted.⁴¹ Beanstalk asserted that the language in the contract gave it the right to 35% of the proceeds from any agreement granting a right in the property and argued that it had evidence that AM General shared this understanding of the plain language in the agreement.⁴² Specifically, Beanstalk sought to offer evidence that:

[S]hortly before AM General sold the Hummer business to General Motors, AM General asked Beanstalk to modify the contract. In particular, AM General sought to expressly exclude certain types of transactions relating to the transfer of rights in the trademark, including ‘agreements between [AM General] and any individual or entity, for the purpose of producing motor vehicles or motor vehicle parts and accessories, even if rights in the [trademarks] are licensed, transferred, or otherwise involved in such agreements.’⁴³

This request suggests that both Beanstalk and AM General understood the contract to mean that transferring the Hummer trademark triggered an obligation for AM General to pay Beanstalk 35% of the deal’s value.

Agreements that accurately reflect the parties’ intentions are routinely found to be valid and enforceable even if they are not particularly well written or turn out to be bad deals. Judge Posner rejected the idea that AM General would have signed a deal that did not maximize its utility in the way *he* would have expected. Posner called the contract “absurd” and affirmed the lower court’s decision granting AM General’s motion to dismiss before Beanstalk could proceed with discovery. Posner reasoned that:

[W]ritten contracts are usually enforced in accordance with the ordinary meaning of the language used in them and without recourse to evidence, beyond the contract itself, as to what the parties meant. This presumption simplifies the litigation of contract disputes and, more important, protects contracting parties against being blindsided by evidence intended to contradict the deal that they thought they had graven in stone by using clear language. It is a strong presumption, motivated by an understandable distrust in the accuracy of litigation to reconstruct contracting parties’ intentions, but it is rebuttable—here by two principles

39. *Beanstalk Grp., Inc. v. AM Gen. Corp.*, 143 F. Supp. 2d 1020, 1027 (N.D. Ind. 2001), *aff’d*, 283 F.3d 856 (7th Cir. 2002).

40. *See id.* at 1032.

41. *Beanstalk Grp., Inc.*, 283 F.3d at 858.

42. *See id.* at 859.

43. *Id.* at 865 (Rovner, J., dissenting).

of contract interpretation that are closely related in the setting of this suit. The first is that a contract will not be interpreted literally if doing so would produce absurd results, in the sense of results that the parties, presumed to be rational persons pursuing rational ends, are very unlikely to have agreed to seek.⁴⁴

This decision leaves one wondering why Posner's assumptions about the typical business relationship are so supremely rational that a deviation from what is typical becomes "absurd." After all, it is certainly within the realm of possibility that some private parties will strike a deal that is different from those Posner generally sees. Posner's strong allegiance to his idea of the typical trademark license agreement (his reference transaction) may have blinded him to the possibility that the actual deal in this case was different. Even in the face of clear contract language and AM General's later efforts to renegotiate, Posner refused to consider the possibility that the facts might actually be atypical. Posner's anchor became the norm, and Beanstalk was denied its day in court.

The dissenting judge vented his frustration with Posner's reasoning, asserting that through the opinion the Court:

[S]ubstitutes its own "cultural understanding," its own "cultural background," and its own general knowledge of the commercial world for a defined term in the contract, a dubious proposition at best. Judges are trained in law, not business, and however cosmopolitan we may be about the world of commerce, I think it an unwise practice to substitute our general knowledge of the business world for the express terms of a contract, especially in the absence of any discovery that might elucidate the parties' true intent.⁴⁵

When attempting to reconstruct a decision-making scenario based on risk, Posner's thinking conformed to the availability heuristic. He clutched an anchor and would not let it go, even in the face of clear language to the contrary.

Judge Posner is not one to be manipulated—even by his own patterns of thinking. Perhaps the best strategy in such a case would be to alert the decision-maker of our tendency to anchor our sense of what is right to what we have seen before, and in doing so, disregard all available information. One could acknowledge the availability heuristic and urge Judge Posner to reject it so that his subconscious anchors will not lead him to disregard the probative value of all available information.⁴⁶ One could acknowledge that the terms in the agreement at issue is not the anchor we normally expect to see in a trademark license or

44. *Id.* at 859–60 (majority opinion).

45. *Id.* at 865–66 (Rovner, J., dissenting).

46. Of course, if Judge Posner is merely maximizing his own utility in making the decision in a way that conforms to his reference transaction (instead of looking at the decision-making process of the parties), there may not be much room for persuasion.

representation agreement. This deal was expressly negotiated to be atypical and formalized in a clear written agreement. Despite its failure to conform to what one might expect, its terms were negotiated between two sophisticated commercial actors, and therefore, one need not apply objective theory or consider what a rational party would have written. We know what they wrote. Especially in a motion to dismiss, such clear text should not be readily disregarded as “absurd.”⁴⁷

Given Judge Posner's prolific body of work, it would not be difficult to find words he wrote that could help distinguish atypical contracts from his reference transactions. For example, not many years later, Posner would write:

Default rules economize on the costs of contracts by saving the parties the bother of negotiating a provision that most of them want—the members of the minority that does not want such a provision are free to contract around it but the majority is saved that bother and expense.⁴⁸

In this way, the interplay of traditional and behavioral economics can help illuminate our innate biases and improve our contract advocacy and decision-making.

IV. THE MARKET FOR SILENCING VICTIMS OF SEXUAL MISCONDUCT

The prevalence of nondisclosure agreements (“NDAs”) shielding perpetrators of sexual misconduct graphically illustrates that there are problems that law and economics does not help us solve. Our uncritical belief in markets may have contributed to problems in contract doctrine that we would prefer not to have. Posner and economic traditionalists have faith that “[i]f voluntary exchanges are permitted and the market is allowed to operate, resources will gravitate to their most valuable uses.”⁴⁹ His work is built on the unshakeable foundation that people maximize individual utility. For those who think laws can and should delineate right from wrong, and that life, liberty, and the pursuit of happiness should inform legal decision-making, Posner's view of the world can sound shockingly amoral and sexist. Given the long wait many have to endure to adopt a child, Posner sees “[n]o reason morality should stop us from selling babies.”⁵⁰ Posner delights in applying rational thinking to procreation and sex, pointing out, for example, “that noncompanionate marriage is poorly designed for channeling sexual activity into marriage.”⁵¹

In twenty-first century America, we must confront whether this type of amoral thinking has resulted in some unsavory and dangerous markets, such as the market

47. *Beanstalk Grp., Inc.*, 283 F.3d at 862.

48. *In re XMH Corp.*, 647 F.3d 690, 696 (7th Cir. 2011).

49. ANTHONY T. KRONMAN & RICHARD A. POSNER, *THE ECONOMICS OF CONTRACT LAW* 1–2 (1979).

50. See Elisabeth M. Landes & Richard A. Posner, *The Economics of the Baby Shortage*, 7 J. LEGAL STUD. 323, 345–346 (1978).

51. RICHARD A. POSNER, *SEX AND REASON* 246 (1992).

for NDAs that hide sexual misconduct. It has become a matter of course for serial sex offenders, like Harvey Weinstein and Larry Nassar, to shield their unlawful acts from public scrutiny with settlement agreements that require confidentiality.⁵² This practice of using private NDAs to hide sexual misconduct has enabled repeat offenders to harm victims who may have been able to protect themselves from harm if the perpetrators' past crimes were not shielded from view.⁵³ The well-established market in NDAs may have maximized the utility of sexual predators. And it may have even benefitted some victims who want to recover from their painful experience privately. Even though utility between the private parties may often be maximized, significant harm may result from permitting perpetrators to shield their conduct from future victims.⁵⁴ Harms to institutions, communities, public health, and safety that flow from such markets are complex, systemic, and hard to fix. In writing about rape, Judge Posner has given us reason to hope that his economic model would support weighing the expense to the community against the "utility monster" and his victim.⁵⁵

The public outrage over these agreements raise important question that are not answered by considerations of criminal conduct alone. Have we permitted a legal market for such abuse where the rich and powerful (the Nassars and Weinsteins) may freely engage in unlawful misconduct and keep their reputations clean if they are willing to pay the victim's settlement price? If so, should states pass legislation stating that NDAs for sexual misconduct violate public policy? Are lawyers who repeatedly represent clients in such matters violating ethical obligations?⁵⁶

Traditional law and economics theorists do not worry about such questions. They believe in their markets. They hold strong to the faith that such transactions

52. See Des Bieler, *Chrissy Teigen Offers to Pay McKayla Maroney's Fine if She Speaks at Larry Nassar Sentencing*, WASH. POST (Jan. 16, 2018), https://www.washingtonpost.com/news/early-lead/wp/2018/01/16/chrissy-teigen-offers-to-pay-mckayla-maroneys-fine-if-she-speaks-at-larry-nassar-sentencing/?utm_term=.4cbc86f3be8f (on file with *The University of the Pacific Law Review*); Matthew Garrahan, *Harvey Weinstein: How Lawyers Kept a Lid on Sexual Harassment Claims*, FIN. TIMES (Oct. 23, 2017), <https://www.ft.com/content/1dc8a8ae-b7e0-11e7-8c12-5661783e5589> (on file with *The University of the Pacific Law Review*).

53. See Nicole Karlis, *How Non-Disclosure Agreements Silence Victims*, SALON (Dec. 10, 2017), <https://www.salon.com/2017/12/10/how-non-disclosure-agreements-silence-victims/> (on file with *The University of the Pacific Law Review*); Mira Sorvino, *Mira Sorvino: The Vindication and Aftermath of My Weinstein Story (Guest Column)*, HOLLYWOOD REP. (Dec. 8, 2017), <https://www.hollywoodreporter.com/news/mira-sorvino-vindication-aftermath-my-weinstein-story-guest-column-1064701> (on file with *The University of the Pacific Law Review*).

54. See Michelle Fabio, *The Harvey Weinstein Effect: The End of Nondisclosure Agreements in Sexual Assault Cases?*, FORBES (Oct. 26, 2017), <https://www.forbes.com/sites/michellefabio/2017/10/26/the-harvey-weinstein-effect-the-end-of-nondisclosure-agreements-in-sexual-assault-cases/#7b35c46b2c11> (on file with *The University of the Pacific Law Review*) ("Unless somebody does this there won't be a debate about how egregious these agreements are and the amount of duress that victims are put under. My entire world fell in because I thought the law was there to protect those who abided by it. I discovered that it had nothing to do with right and wrong and everything to do with money and power.").

55. POSNER, *supra* note 51, at 386–87.

56. See generally Jon Bauer, *Buying Witness Silence: Evidence-Suppressing Settlements and Lawyer's Ethics*, 87 OR. L. REV. 481 (2008).

will only be banned if it is efficient to do so or favorable to a politically powerful interest group.⁵⁷ Neither reason has inhibited the market for NDAs that hide sexual misconduct. If states ban these NDAs with legislation, the new laws will be based on a shared moral compass, not efficiency or the protection of the more powerful. The public policy justifying these bans would be to protect people who are less powerful, like our children, who have no ability to participate in the market or vote to elect decision makers who can change it.

Judge Posner has not yet written about the validity of NDAs hiding sexual misconduct, and there is reason to hope that they may provide an interesting thought experiment for him to display his prowess for showing that markets can solve this problem too. In the context of blackmail, Posner conceded that prohibitions against voluntary transactions could be justified if the transactions impose involuntary costs on third parties. He wrote that:

[S]ecrecy is entitled to legal protection where it is necessary to protect an investment in the acquisition of socially valuable information, but not where it serves to conceal facts about an individual, that if known to others, would cause them to lower their valuation of him as an employee, borrower, friend, spouse, or other transactor.⁵⁸

Judge Posner could apply this reasoning to support legislation banning NDAs that hide sexual misconduct. I wrote to Judge Posner asking to hear his thoughts on this matter. So far, months have passed without an answer.

Meanwhile, some states are taking action. In 2018, the New York legislature passed a bill forbidding employers from settling sexual harassment claims with agreements that “would prevent the disclosure of the underlying facts and circumstances . . . unless the condition of confidentiality is the plaintiff’s choice.”⁵⁹ Also in 2018, California enacted legislation stating that an NDA designed to hide criminal sexual misconduct or sexual misconduct directed at a minor violates public policy, and if entered after January 1, 2017, is void as against public policy.⁶⁰ The statute further provides that lawyers who facilitate such agreements may be disciplined for ethical violations.⁶¹ Similar legislation is pending in Pennsylvania and New Jersey and was introduced as the “EMPOWER” Act in the U.S. House and Senate.⁶²

Behavioral economics provides a sound theoretical explanation for the desire to outlaw such agreements. Behavioral economists challenge the traditional law

57. See Jolls, *supra* note 10, at 1516.; Posner, *supra* note 2, at 1551.

58. Richard A. Posner, *Privacy, Secrecy, and Reputation*, 28 *BUFF. L. REV.* 1, 2 (1978).

59. N.Y. C.P.L.R. § 5003-b (McKinney 2018). The statute further permits the plaintiff to have seven days to retract such a preference.

60. CAL. CIV. PROC. CODE § 1002 (West 2018).

61. *Id.* § 1002(e).

62. S. 2994, 115th Cong. § 4(a)(1) (2018); H.R. 6406, 115th Cong. (2018); SB 121, 2018 Leg., 2018–2019 Reg. Sess. (N.J. 2018); SB 999, 2018 Leg., 2017–2018 Reg. Sess. (Pa. 2017).

and economics idea that people act with no sense of community, as though we are all players in a game where the object is maximizing self-interest. Our desire to ban sexual harassment NDAs comes from the human instinct that laws should promote fairness. When our laws protect such agreements, have we all become complicit in maintaining the perpetrator's secrecy and hiding his conduct from future victims? If we do not want to encourage market forces that hide sexual misconduct, we have to articulate a justification for shutting down the market to protect children and other victims from future harm. One may claim that shutting down such a market maximizes utility. But the true value goes not to those who support the legislation, but to the person who is notified of the bad actor and escapes harm. And while we may genuinely share a desire to protect the next child, that is not the only force motivating our desire to outlaw NDAs that shield sexual misconduct. If our elected representatives enact legislation finding that such agreements violate public policy, it will be because they violate our common sense of decency. We admire those who defy this market so much that those brave enough to face the consequences of violating their NDAs were named *Time Magazine's* 2017 persons of the year.⁶³ Or to put it as a behavioral economist would, our reference transaction for this type of pay-off is that there should be no transaction at all.

In stark contrast to traditional economic analysis, behavioral economics provides an explanation and a positive brand for this inclination: fairness entrepreneurship.⁶⁴ For all our many differences in twenty-first century America, we still have a cultural moral compass, and these NDAs violate it. Behavioral economists have demonstrated that we are not as self-interested as Posner's work describes. We do not run on utility and markets alone. As humans, we use a sense of fairness to navigate our lives and make decisions.⁶⁵

V. CONCLUSION

The heavy weight of empirical support for the findings of behavioral economics requires rethinking the extent to which law and economics has influenced contracts doctrine. Law and economics principles have given us an important view of contract law, but it is not the only useful view. In critically examining the legacy of law and economics, we must confront the fact that, in some domains, our faith in markets has created harms that other disciplines may lead us to fix. Behavioral thinkers have made economics more human.⁶⁶ Posner's own thinking on behavioral economics appears to be evolving. Twenty years ago,

63. See Stephanie Zacharek et al., *The Silence Breakers*, TIME (Dec. 18, 2017), <http://time.com/time-person-of-the-year-2017-silence-breakers/> (on file with *The University of the Pacific Law Review*).

64. See Jolls, *supra* note 10, at 1510.

65. See *id.*

66. See John Cassidy, *The Making of Richard Thaler's Economics Nobel*, NEW YORKER (Oct. 10, 2017), <https://www.newyorker.com/news/john-cassidy/the-making-of-richard-thalers-economics-nobel> (on file with *The University of the Pacific Law Review*).

Judge Posner criticized the Jolls, Thaler, and Sunstein paper as a collection of “cognitive quirks.”⁶⁷ He said they have no “theory to set against rational-choice theory.”⁶⁸ Interestingly, Posner’s own anchor on the subject appears to be shape shifting. In his newest book, *Divergent Paths*, Judge Posner revisits the validity of behavioral economics and now admits that, like economic analysis of law, behavioral economics has some validity.⁶⁹ Judge Posner’s past thinking on contract law should be read with that concession in mind.

67. See Posner, *supra* note 2, at 1558.

68. See *id.*

69. POSNER, *supra* note 5, at 33.